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HOW TO HELP THE WORKING POOR; AND PROBLEMS OF THE WORKING POOR

HEARINGS

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

FEBRUARY 28; MARCH 21; AND APRIL 27, 1989

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HOW TO HELP THE WORKING POOR

TUESDAY, FEBRUARY 28, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Thomas J. Downey (acting chairman of the subcommittee) presiding.

[The press releases announcing the hearings follow:]

FOR IMMEDIATE RELEASE
FRIDAY, FEBRUARY 10, 1989

PR #1
SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON HUMAN RESOURCES, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS ON HOW TO HELP THE WORKING POOR

The Honorable Thomas J. Downey (D., N.Y.), Acting Chairman, Subcommittee on Human Resources, Committee on Ways and Means, U.S. House of Representatives, today announced that, on Tuesday, February 28, 1989, the Subcommittee will hold a hearing on how to help the working poor. The hearing will be held in room B-318 Rayburn House Office Building and will begin at 10:00 a.m.

In announcing the hearing, Chairman Downey said, "Five and a half million Americans live in poor families in which someone works full time all year yet they are still poor. These families are among the most vulnerable of the poor. They are eligible for few government benefits and are struggling to meet their bills. My goal is simple: families that work should not be poor. At this hearing we will discuss ways to achieve that goal."

Background

Nearly 20 million poor adults and children live in households in which someone works during the year; they constitute close to 60 percent of the poverty population. Census Bureau data demonstrate that the working poor population is growing; the number of working age individuals who work but are still poor was 44 percent larger in 1987 than in 1978. Moreover, the number of people who work full-time year-round and are still poor increased more than 42 percent between 1978 and 1987.

Although the nation has experienced economic growth in recent years coupled with an increase in overall family income, the returns to work for low-wage earners have been decreasing. In fact, the poorest 20 percent of families with children experienced an income loss of 22 percent between 1973 and 1987. In addition, overall wage levels have remained relatively stagnant over the past six years. Median weekly wages for full-time workers were lower in real terms in 1987 than in any year in the 1970s. There is also growing evidence that wages for low-paying jobs have fallen off significantly compared to average wages.

(MORE)

Oral testimony before the Subcommittee will be limited to invited witnesses only at this hearing. Witnesses are expected to review the current status of the working poor and discuss proposals for addressing their needs. Public hearings will be announced in a subsequent press release.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 75 copies of their prepared statements to the Subcommittee office, B-317 Rayburn House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENT IN LIEU OF PERSONAL APPEARANCE:

Persons wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Tuesday, March 14, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and interested public, they may deliver 75 additional copies for this purpose to room B-317 Rayburn House Office Building on the date of the hearing.

SEE FORMATTING REQUIREMENTS BELOW:

COMMITTEE ON WAYS AND MEANS FORMATTING REQUIREMENTS FOR PRINTING OF HEARING STATEMENTS, WRITTEN COMMENTS AND EXHIBITS

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

FOR IMMEDIATE RELEASE
TUESDAY, FEBRUARY 28, 1989

PR #3
SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON HUMAN RESOURCES, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES ADDITIONAL HEARING ON THE PROBLEMS OF THE WORKING POOR

The Honorable Thomas J. Downey (D., N.Y.), Acting Chairman of the Subcommittee on Human Resources, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a second hearing on the problems of the working poor, beginning at 10:00 a.m. on Tuesday, March 21, 1989, in room B-318 of the Rayburn House Office Building.

In announcing the hearing, Chairman Downey said, "One of the most widely-held beliefs in American society is the belief that if you work hard, you can make it. All of us, however, have heard of families that work hard but are still unable to escape poverty. And, as census data indicate, and our expert witnesses today will undoubtedly testify, the numbers of families who find themselves impoverished, despite hard, honest labor, is growing."

At the hearing, witnesses are asked to testify about the problems of the working poor population, the reasons for poverty among working families, economic and other factors underlying the growth in the working poor population, and the demographic characteristics of the working poor. The Subcommittee is also interested in testimony about the role that various public programs and policies might play in supporting the work efforts of the poor. What can we do at the Federal level to increase the return to work -- which has fallen significantly for this population? What specific policies might we enact to reduce the costs of going to work, such as the high cost of child care? And which of the various policy proposals would work in the most efficient and targeted manner?

A third hearing will be scheduled for a later date if necessary. For background information on the working poor, see Subcommittee on Human Resources press release #1, dated February 10, 1989.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler or Diane Kirkland [(202) 225-1721] no later than the close of business, Friday, March 10, 1989. The telephone request must be followed by a formal written request to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee [(202) 225-1025].

(MORE)

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. **(See formatting requirements below.)** This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear are required to submit 75 copies of their prepared statements to the Subcommittee office, B-317 Rayburn House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Tuesday, April 4, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public, they may deliver 75 additional copies for this purpose to the Subcommittee office on the day of the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

FOR IMMEDIATE RELEASE
TUESDAY, APRIL 4, 1989

PR #4
SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-1721

THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON HUMAN RESOURCES, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING AT WHICH THE BUSH ADMINISTRATION WILL TESTIFY ON THE PROBLEMS OF THE WORKING POOR

The Honorable Thomas J. Downey (D., N.Y.), Acting Chairman, Subcommittee on Human Resources, Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold a final hearing on the problems of the working poor, and how to help working poor families. The hearing will be held on Thursday, April 27, 1989, in room B-318 Rayburn House Office Building, beginning at 10:00 a.m.

In announcing the hearing, Chairman Downey stated: "At our earlier hearings we heard testimony from Members of Congress, academic experts and public witnesses. At this hearing we will turn to the Bush Administration for their assessment of the problem, and their suggestions on how to assist working poor families. To make work pay again for these families, we will need the President's help. This hearing will give us a sense of the Administration's commitment and its perspective on how to get the job done."

Oral testimony before the Subcommittee will be presented by the Honorable Elizabeth Dole, Secretary of Labor. (For information about earlier hearings, please see press releases #1 and #3.)

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business Wednesday, May 10, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and interested public, they may deliver 75 additional copies for this purpose to room B-317 Rayburn House Office Building on the date of the hearing.

SEE FORMATTING REQUIREMENTS BELOW:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will **not** be printed, but will be maintained in the Committee files for review and use by the Committee.

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4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Acting Chairman DOWNEY. The subcommittee will come to order. I have a brief opening statement.

Americans are dreamers. After all, this is the land of opportunity, where if we imagine it, we can achieve it. We believe that by working hard each and every one of us can feed and clothe our children, give them a solid education, and then watch them—as they travel to Mars, find a cure for AIDS, or simply become good citizens. This is what we hope is true in America—that hard work brings just rewards and fulfills dreams.

For many Americans the dream has died. Work simply does not pay. There are some families in this country who, like you and me, go to work everyday, and work hard to provide a good life for their children. But unlike you and me, these families aren't making it. They are playing by the rules, but cannot escape poverty.

Roughly 19 million individuals live in households where work is done, but poverty is a way of life. And a majority of them live in families with children. Between 1979 and 1987, the number of working poor families with children increased more than 30 percent. In more than 5.5 million households someone is working full-time year round.

Today's solutions to poverty in America are almost always built on self-sufficiency. The experience of the working poor seems to mock that premise, however. Reflect for a moment. We just passed a welfare reform bill that expects welfare families to move away from welfare and toward work. But what does our economic system do about helping those who work to make it? It rewards them with a poverty level income. Clearly, something must be done.

I look forward to a constructive and informative session today on the problems of the working poor. I am pleased that Senator Al Gore is able to be with us to share his views, along with other Members of Congress who are interested in this issue and who have sponsored legislation. In addition, I welcome the chance to hear from some respected experts, including David Ellwood, who just happens to have published a book on the problems of the working poor. Thank you all for joining us today.

Before I begin, I would like to announce that we will hold the second hearing on the working poor on March 21, at which the public will be given an opportunity to testify.

At this time I welcome my ranking minority member, Mr. Shaw and Mr. Coyne, a new member on our subcommittee.

Clay, do you have an opening statement?

Mr. SHAW. Yes, I do. I would like to ask to revise and extend my remarks.

Acting Chairman DOWNEY. Without objection, Mr. Shaw.

Mr. SHAW. Mr. Chairman, you are to be commended for holding these hearings today on the working poor. I feel very strongly that there is no economic issue of greater importance to America's future.

As our subcommittee prepares itself to write this legislation to help the working poor, our members should keep four facts firmly in mind.

First, more Americans work now than ever before. Due in large part to increased work by mothers, we open our study of poverty and low income among working Americans on an optimistic note—

the tradition of hard work by American citizens has never been more honored by practice than it is at this very minute.

Second, wage levels are near their all-time high. Some of those we hear from this morning may well assert that the millions of new jobs generated by our economy over the past several years are low wage and dead end. I expect that Dr. Kosters will have more to say on this subject. But having examined some of the numbers, I can assure the members of the committee that the truth about wages is complex and subtle. For example, although the wages of nonsupervisory workers have been increasing in recent years, they are still lower than they were in 1973. But if the earnings of all workers is considered and if employee benefits are included, the average wage earnings are near their all-time high. Better still, they have been increasing steadily since 1982.

If we now switch our measure of well-being from wages to total personal income per capita by including interest earnings, Government transfers, dividends, and so forth, we can be very optimistic indeed. Between 1970 and 1987 this comprehensive measure of income increased 38 percent, despite the fact that taxes were somewhat higher in 1987 than 1970. This conclusion is confirmed by the recent CBO report showing that the average income of American families increased by 20 percent between 1970 and 1986. Even more impressive, the income of couples with children increased by 26 percent.

The third fact we should keep in mind while considering legislation for the working poor is that the Federal Government has upheld its role in helping Americans achieve economic security. Using 1970 as the base year, Federal expenditures on AFDC, food stamps, and Medicaid are up by well over 200 percent. Moreover, spending on housing, child nutrition, and Headstart are at an all-time high.

While it is true that most of this spending is for people below the poverty level, it is simply not true that the Federal Government has ignored the working poor. The nonpoor are eligible for most of the child nutrition programs, for housing, for education, food stamps, home heating, some health programs, and if they recently left AFDC due to earnings, for Medicaid. Moreover, we spend over $4 billion subsidizing child care through the Tax Code. This program will cover up to 30 percent of the costs of day care for working low-income families. One of the most rapidly growing Federal programs is the earned income tax credit. By 1990 we will use this program to help nearly 14 million low-income families and supplement their earnings by about $7.5 billion.

Nevertheless, the fourth fact about the working poor is that despite their own efforts and the Federal programs just summarized, their failure to escape poverty signals some problems in our economic system. I agree with you, Mr. Chairman, that a goal of Federal policy should be to assure that families with full-time workers are able to escape poverty.

On this count, I want to thank Mr. Downey, Mr. Miller, and Senator Gore for recognizing what Republicans have realized all along. While members of other committees declare a day care crisis or a wage crisis, and propose spending billions on outmoded and heavy-handed tools of Government bureaucracy on market intervention,

INTENTIONAL BLANK

Mr. Downey and his colleagues have the foresight to join our President and the many Republicans who introduced bills in the last Congress to use the Tax Code to supplement the income of working families.

We begin our work, then, with bipartisan agreement on the nature of the problem and on the best solution. Our intent is to provide cash subsidies to low-income families that work. The major questions before us are how much we want to spend on these subsidies and how we plan to finance the spending. I look forward to reaching a compromise on these matters over the next several months, and to originating bipartisan legislation here in the Ways and Means Committee that the President can sign into law by next fall.

Thank you, Mr. Chairman.

Acting Chairman DOWNEY. Bill.

Mr. COYNE. I have no opening statement.

Acting Chairman DOWNEY. Hank.

Mr. BROWN. Thank you, Mr. Chairman. The only comment I'd like to add to the several fine statements that have been made is simply to welcome our old colleague back to the House. We're delighted that he'd take the time to come share his suggestions and thoughts with us.

Acting Chairman DOWNEY. Senator Gore.

STATEMENT OF HON. ALBERT GORE, JR., A U.S. SENATOR FROM THE STATE OF TENNESSEE

Senator GORE. Thank you very much, Mr. Chairman. I appreciate the kind words of welcome. To Congressman Shaw, Congressman Coyne, Congressman Brown, and other members of the subcommittee, it is indeed good to be back with friends on both sides of the dividing line on the subcommittee and in the House.

I see Paul Henry in the audience who will testify later and George Miller and others who will testify. This is an idea or a set of ideas whose time has come. While we believe there are other ideas whose time has come as well, we are particularly committed to this particular approach.

Mr. Chairman, let me say that in appearing here to speak on behalf of so many millions in our Nation who work hard, yet still are poor, I wish to commend you as my friend as well as as the chairman of this subcommittee for the many efforts you've made on the Downey-Gore bill to help the working poor.

We've talked about this, the two of us, for 6 to 8 months now or longer, and it has been a lot of fun working with you on it. I'm excited about the chances for really providing some substantive and meaningful relief for the condition we refer to as "working poor."

We ought to make that phrase obsolete. If someone is willing to work, they ought not be poor. The goal of making it obsolete really shouldn't be regarded as overly idealistic. It's just as American as apple pie.

The fact that we've gotten away from that principle in recent years is something that should trouble all of us, Democrats and Republicans alike, greatly because our country was built on the belief that if you were willing to work hard, you could get ahead.

Equally fundamental to this principle is the notion that people who work should be better off than people who are on public assistance. And yet, there are millions of Americans who are actually given a very strong economic signal, particularly if they have children, that they are better off financially if they stay on welfare than they would be if they get out and find a job and go to work even if it is at the minimum wage.

We ought to change that. The 1980's have shattered that work principle and we're trying to restore it.

It's time to give the working poor economic freedom. We ought to make the promise that no one who works should live below the poverty line a part of our social contract.

There are an estimated 9 million working poor in America. Nearly 20 million poor adults and children live in households in which someone is in the work force and is working during the year. And the ranks of the working poor keep growing because of wage inequality and an influx of low wage jobs.

The roots of this poverty are no mystery. The minimum wage has not been increased in 7 years. A full time job paying the minimum wage provides an annual wage of only $6,968. I don't know how any family can get by on so little.

It really is a disgrace that somebody with two kids who works at the minimum wage 40 hours a week, 52 weeks a year, can't even get close to the poverty line. That ought to be changed.

Meanwhile, our economy is shifting toward fewer high paying jobs and more low wage earning jobs. According to a report compiled last fall by the Democratic Policy Committee in the Senate, only 10 percent of the private sector jobs created since 1981 have been in industries with above average earnings. Eighty percent of the new jobs in this decade have been in the lower paying services and retail trade industries.

We need to make hard work worthwhile again for those who work and for the welfare dependent who could be working. The working poor often find themselves living as far below the poverty line as welfare families in which no one is working.

And, of course, as this subcommittee is extremely well aware, while welfare recipients have access to health care, 40 percent of the working poor have no health insurance.

Many families are reluctant to forego welfare. They think they will become poor by going to work.

Your subcommittee, I would say, Mr. Chairman and Congressman Shaw, made giant steps forward in the last Congress by designing and initiating the landmark welfare reform measure.

I remember very well, Mr. Chairman, when you and I went to visit welfare offices in California, for example, and spent an enormous amount of time dealing with their lifetime stories, what challenges you are facing. You embodied many of those learning experiences in the bill, which passed last year.

I know that you wanted it to go farther than it did, but we also heard at that time over a year ago about the problems of people on welfare not being able to get child care if they go back onto the work rolls.

So, we're back this year to try to deal with that problem, with the Employment Incentives Act. You've introduced it here in the

House along with George Miller and John Lewis and others. I have introduced it in the Senate in order to provide tax relief for the working poor.

It doesn't create any new programs. It simply changes existing Federal laws to target aid to families with low incomes and make the benefits of their work a little greater.

The bill will do three things:

First, increase the earned income tax credit and adjust it for family size;

Second, make the dependent care tax credit refundable to those with very low incomes and increase the average amount of the credit available to low income families; and

Third, it will increase funding for the title XX social services block grant to provide additional resources for child care and training of child care providers.

Now let me say that this is not intended as an alternative or substitute for other measures in this area. You and I, Mr. Chairman, support the act for better child care and the bill to increase the minimum wage.

We believe very deeply that this measure should be pushed as a priority because it targets the need, but these other measures are needed as well.

But let me explain the provisions of our bill just a little bit more and then respond to any questions you might have.

Up to the maximum level under current law, the earned income tax credit provides benefits to those who are working. But under current law, a family of four with an income of $10,000 will receive an earned income tax credit of only $953 in 1990.

Under our proposal, because of the expanded benefit and because it would be sensitive to the number of children in the family up to two, that same family would qualify for a credit of $2,043.

The EITC portion of the Employment Incentives Act, the Downey-Gore bill, would expand the EITC and vary the size of the credit by income level and by family size.

A family with two or more children would receive a higher credit than a family with only one child. This commonsense change recognizes that a family's needs are a function of size as well as income.

The other two aid provisions of the bill involve child care. But before explaining them, let me just briefly share with you some thoughts and comments that I heard just 2 weeks ago when I visited a child care center in Knoxville, Tennessee, the Western Heights Child Care Center.

I want to tell you what some of the mothers at that center told me. I heard, for example, from Carolyn Price, a Western Heights project tenant, who hopes that with a little help from this legislation she might be able to provide a better future for her daughter Kaitlyn.

She is separated from her husband and provides for her needs and those of Kaitlyn through public assistance. She is presently studying information systems technology at Pellissippi State Community College and expects to graduate this spring.

She is optimistic that she can find a job as an office manager, but before she can realize her goal of independence, she has got to somehow find affordable child care for her 3-year-old daughter.

She told me, and I quote, "It's a great fallacy that people on welfare want to stay on welfare. That's ridiculous. Everybody wants to do better for themselves. They want to do better for their children."

But before she goes out and gets this job, she has got to be satisfied that her child is well and safely taken care of and that she can afford the expenses associated with that care.

I also met Sherri Kellar, a mother of three from Montgomery Village in South Knoxville. She expressed hope that the bill will become law by the time she's ready to become a part of the work force.

She's now studying nursing at Knoxville Vocational Technical School. She said the bill will help tremendously. And again, I'm quoting, "For three children, day care will run $400 a month and with what I will be making, that will be about half of my pay."

Well, the child care provisions of our bill will help Ms. Price, Ms. Kellar, and thousands of other families in similar situations.

The bill will modify the existing dependent care tax credit, which is the largest Federal program providing child care benefits for working parents. At present, the dependent care tax credit is a non-refundable credit against income tax liability available for up to 30 percent of a very limited amount of child care expenses.

But the child and dependent care credit does have a major deficiency in not providing any relief to a family with an income so low that it has no tax liability. And as I said earlier, those families frequently need help with their child care expenses the most.

That means it is no use to those families who need assistance the most and if they have no money, if they have no child care, the program on the books to help them with child care simply doesn't give them assistance. So they are encouraged to stay on welfare.

Now a work subsidy that discriminates against the poor is counterproductive in the extreme. So we make this tax credit refundable.

And, finally, Mr. Chairman, we also increase, the title XX social services block grant. Your subcommittee has devoted an enormous amount of time to title XX and it is greatly needed so that States have sufficient resources to aid the poorest of working families.

Even though our bill in its other provisions will provide relief to working poor families, some families do indeed need greater assistance of the kind provided under title XX, which will allow States to extend child care training activity and assure parents of better quality child care from which to choose.

Now, in conclusion, we also include provisions in the bill to raise the revenue to pay for it. In 1989 and in the 1990's I think it is responsible to put forward ideas on how to finance new ideas that are proposed.

There are alternative ways for financing this bill. The committee may wish to consider alternatives, but the measure that we provide in the legislation is eminently fair. It will raise the revenue to fully finance the bill and at the same time reduce the deficit by $5 billion.

So, again, if others have suggestions on better ways to finance it, as the Senate sponsor, I certainly have an open mind on that and

encourage alternatives to be explored. But I certainly believe that this is the best way to do it.

I think that we need to tell Americans that the American dream is still alive and that those who are willing to work and who have children have a realistic hope of achieving the American dream.

So I want to urge members of the subcommittee to favorably consider the Employment Incentives Act.

Thank you, Mr. Chairman.

[The statement of Senator Gore follows:]

Testimony of Senator Al Gore

House Subcommittee on Human Resources

Hearing on How to Help the Working Poor

February 28, 1989

Mr. Chairman, I appreciate the opportunity to come before your subcommittee to speak on behalf of the millions in our nation who work hard, yet still are poor. I commend you for calling this hearing, and I applaud your efforts on the Downey-Gore bill to help the working poor.

This country was built on the belief that if you worked hard, you would get ahead. For two centuries, Americans have taken comfort in knowing they could work to earn a better life for their children. But the 1980s have shattered that fundamental principle. Today, millions of Americans are working hard and still falling behind. They remain locked in the clutches of poverty -- prisoners of economic forces they cannot control.

It is time to give the working poor their economic freedom. We should make this promise a part of our social contract: No one who works should live below the poverty line -- not in America.

There are an estimated nine million working poor in this country. Nearly 20 million poor adults and children live in households in which someone is in the work force and is working during the year. And the ranks of the working poor keep growing because of wage inequality and an influx of low-wage jobs.

The roots of this poverty are no mystery. The minimum wage has not been increased in seven years. A full-time job paying the minimum wage provides an annual wage of only $6,968. I don't know how any family can get by on so little.

Meanwhile, our economy is creating more and more low-wage jobs. According to a report compiled last fall by the Senate Democratic Policy Committee, only 10 percent of the private-sector jobs created since 1981 have been in industries with above-average earnings. Eighty percent of the new jobs in this decade have been in the low-paying services and retail trade industries.

We need to make hard work worthwhile again for those who work and for the welfare dependent who could be working. The working poor often find themselves living as far below the poverty line as welfare families in which no one is working. For example, while welfare recipients have access to health care, 40 percent of the working poor have no health insurance. Many families are reluctant to forego welfare if they think they will become poorer by going to work.

We simply must adopt policies that reward work and encourage families to succeed; policies that will assure that families are better off working than on welfare; policies that reinforce the work ethic and that say that people who work should not be poor.

Mr. Chairman, the Employment Incentives Act, which you have introduced here in the House and I have introduced in the Senate, is just the approach the working poor need. The Downey-Gore bill provides tax relief for the working poor. It does not create any new programs. It will simply change existing Federal laws to target aid to families with low incomes and make the benefits of

their work a little greater. The bill will do three things: First of all, it will increase the earned income tax credit and adjust it for family size. Second, it will make the dependent care tax credit refundable to those with very low incomes and increase the average amount of the credit available to low-income families. And third, it will increase funding for the Title XX Social Services Block Grant, to provide additional resources for child care and training of child care providers.

Let me explain these provisions further. The Earned Income Tax Credit was first enacted in 1975. It was designed to provide tax relief for low-income working families with children. It also provides an incentive to work: only those who do work get the credit. Up to the maximum income level, the more a person works, the greater the earned income tax credit benefit. The EITC portion of the Employment Incentives Act would expand the EITC and vary the size of the credit, not only by income level, but also by family size. A family with two or more children would receive a higher credit than a family with only one child. This common sense change recognizes that a family's needs are a function of size as well as income.

The other two aid provisions of the Employment Incentives Act involve child care. But before I explain them, I want to share with you some thoughts and comments expressed to me a few weeks ago when I visited the Western Heights Child Care Center in Knoxville, Tennessee, and talked to constituents about our recently introduced bill and their child care concerns.

I heard from Carolyn Price, a Western Heights project tenant, who hopes that with a little help from Washington she will be able to provide a better future for her daughter Kaitlyn. Ms. Price is separated from her husband and provides for her needs and those of Kaitlyn through public assistance. She is studying information systems technology at Pellissippi State Community College and expects to graduate this spring. She is optimistic that she can find a job as an office manager. But before she can realize her goal of independence, she has to find child care she can afford for her three-year-old daughter.

Ms. Price told me, "It is a great fallacy that people on welfare want to stay on welfare. That's ridiculous. Everybody wants to do better for themselves. They want to do better for their children."

I also met Sherri Kellar, a mother of three from Montgomery Village in South Knoxville. She expressed hope that the bill becomes law by the time she is ready to become a part of the work force. She is studying nursing at Knoxville Vocational Technical School. She said the bill "will help tremendously. For three children, day care will run $400 a month, and with what I will be making that will be about half of my pay."

The child care provisions of our bill will help Ms. Price, Ms. Kellar, and thousands of families in similiar situations.

This bill will modify the existing dependent care tax credit, which is the largest Federal program providing child care benefits for working parents. At present, the dependent care tax credit is a nonrefundable credit against income tax liability available for up to 30 percent of a limited amount of child care expenses.

But the child and dependent care credit has a major deficiency: It will not provide any relief to a family with income so low that it has no tax liability. That means it is no use to the families who need assistance with child care the most. If they have no money, and if they have no child care, the program on the books to help them with child care does not give

them any assistance in staying on the job. Work "pays" less for these low-income families than it would if they were able, like wealthier families, to offset employment-related child care expenses. A work subsidy that discriminates against the poor is counterproductive, to say the least. These are the families who most need help paying for the child care that allows them to keep their jobs. Therefore, we will make this credit refundable.

The Employment Incentives Act also will increase the Title XX Social Services Block Grant to ensure that states have sufficient resources to aid the poorest of working families with child care expenses. Although a refundable day care credit will provide some relief to working poor families, some families will need greater assistance. In addition, not all of those eligible will take advantage of the credit. Some families will be unaware of eligibility, and others will find the tax system overwhelming and unfathomable. Even so, those who use the credit will find it reimburses only 30 percent of the family's child care expenses. In increasing the Title XX entitlement, we will assure that States have sufficient resources to fill the gaps.

The increased Title XX funds also allow States to extend child care training activity, assuring parents of better quality child care from which to choose. After all, the knowledge that children are being cared for by competent and well-trained providers, whoever they may be, is the best assurance for parents that children are safely cared for while they are at work.

Finally, we include provisions in this bill to raise the revenue to pay for it. The bill is not cheap, but as we know, things that are worthwhile and work, seldom come without cost. To finance the provisions of the Employment Incentives Act, we are proposing to adjust the design of the tax system to correct a flaw known as the "bubble" that is left over from tax reform. In the final version of the Tax Reform Act, the effective marginal tax rate for a couple with two children earning roughly between $80,000 and $210,000 a year is 33 percent. But for a couple with two children with an income above $210,000, that marginal rate drops back down to 28 percent.

Eliminating the "bubble" and requiring the wealthiest Americans to pay the same marginal tax rate as those in the bracket just below them will finance this entire measure for working families with children. In fact, there will be enough left over to reduce the deficit by about $5 billion.

The Employment Incentives Act offers a few simple steps to address a difficult problem. It is fair. It is needed. It will work.

I'm not ready to give up on the American dream, and neither are most Americans. By passing the Downey-Gore bill, we can promise American families once again that hard work will build a better life.

Thank you.

Acting Chairman DOWNEY. Thank you, Senator Gore. Let me say that we welcome your leadership on this matter in the Senate.

I just have one question. I note my colleagues are all here and I don't want to trespass on their time.

I don't know that there have been studies of this, but do you share the view that being poor places an enormous pressure on families that otherwise would not be there if they had additional income for example, greater divorce rates, greater incidence of child abuse, and family dislocation?

Senator GORE. Well, I hear that constantly and see the evidence of it constantly at the open meetings or townhall meetings that I conduct.

I've had 100 town hall meetings in Tennessee since December 1st, one in each of our State's 95 counties. At nearly every one of them I find the evidence of families that have been under enormous pressure because of poverty.

Frequently, of course, it's also true that after the husband leaves the home, and typically—not exclusively, but typically it is the husband that leaves the home and the mother who continues raising the children—they find a difficult time getting child support payments. And this subcommittee has been active, along with the full committee, in pursuing options for solving that problem.

But in recounting these troubles, citizens often tell me that the pressures which led to the break up of the family were that they were constantly under financial pressure and that they didn't see a realistic way out.

So there are benefits not often counted on the financial ledger if we make it easier for families to dream together and to stay together to work out their problems together and build toward a higher standard of living.

Acting Chairman DOWNEY. Thank you.

Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I'd like to join with you in welcoming the Senator back to the Senior House. Somehow you look more comfortable over here than you did with those guys over there. And that's meant as a compliment, believe me.

When you talk about your constituent, Mrs. Price, and the fact that she's going to college and planning to begin work at a level above the minimum wage, I think perhaps that's where we have failed the working poor.

We have failed those that are in the welfare trap. We look only at that entry level and they only look at that entry level and perhaps that's the biggest flaw in the entire system.

Our generous human welfare system competes with the wages and net benefits after all the expenses of those who work.

But those Mrs. Prices of the world who are going back to school and completing their education, even though they have young children, are looking beyond that entry level wage. They may not plan to attend college, which is a tremendous hardship with children and having to make a living, but they are clearly not planning to stay at either the welfare or minimum wage level.

And I think we are now failing these people. You commented in your remarks that people should be able to work and better themselves and become more and more independent. I agree, and would

argue that we should gear any assistance that we're going to give to encouraging these workers and making it easier for them to get ahead.

But what can we do beyond helping with child care to help these new workers have a vision beyond the entry level?

Senator GORE. Well, first, I think it's important to note that the specific example that you and I both referred to is of a woman who is not looking far beyond the entry level. She is looking at a job that is slightly less than $5 an hour.

Mr. SHAW. I look at the wage level of people coming off welfare. Typically, these people get something near the minimum wage.

Senator GORE. Right. I agree with you. But she's not looking that far beyond it. But I think that we have to look at the interconnection of a lot of factors in order to answer your question.

How can JTPA be improved to get at not just the cream of that particular crop, not just those who are the most employable among those needing training, but reach farther down to get those who need more basic skills in order to get into the sort of training programs that vocational schools offer.

But I honestly believe that we have long underestimated the basic economic message that we send to families by telling them, not in words, but in dollars and cents, that they are better off staying on public assistance than they are in going to work. One is an available option frequently that provides a certain amount of subsistence level income, no more than that and sometimes right bumping at the level.

But we ought to always provide more incentives for someone to work than to be on welfare. I think that all of the other programs and approaches are likely to fail unless we get at this basic problem of giving a financial incentive for people to dream and to aim at the entry level or slightly beyond the entry level and get back onto the work rolls.

Now if the person we're discussing has children, we've got to open our eyes and see what that person sees, and that is the predicament of unaffordable child care.

If that person cannot get her child into safe, comfortable, adequate circumstances, she is not going to make the transition back on to the work rolls.

And our public policy up until now with the dependent care credit not refundable, with earned income tax credit very small and not sensitive to whether or not a child or children are present in the family, our policy has not seen the dilemmas that working parents face and the challenges that the working poor have in getting back on the work rolls.

Later on the subcommittee is going to hear from David Ellwood, who Congressman Downey earlier referred to. I went up to the Kennedy School and heard a lengthy presentation. I've heard him in other forums and I think he is a representative of a whole community of scholars and persons with practical experience in puzzling through solutions to this problem who are in broad agreement, and I don't want to overstate it, but I believe this to be the case, that the broad approach embodied in this legislation is the single most effective approach our country could take in helping people like Sherri Kellar and Carolyn Price.

Mr. SHAW. Thank you, Mr. Chairman.

Acting Chairman DOWNEY. Bill.

Mr. COYNE. No, Mr. Chairman.

Mrs. KENNELLY. Yes, Senator Gore. In listening to your remarks this morning and listening to your report or Sherri Kellar and individuals you spoke within the Montgomery Village in South Knoxville, much of what you have to say we said last year and the year before when we did welfare reform. In your remarks you're almost back to that same position.

Do you see your new bill as an addition to welfare reform, or do you see it as a continuation? And then I'll add a caveat to that, do you see your bill being able to do the good you'd want it to do when you see that the full funding—at least what was minimum funding for Welfare Reform last year—is not even in the budget this year?

Are we still just fighting the waves? Or is there—are we really doing something?

Senator GORE. Yes, we are. And this subcommittee has taken the key step, last year, along with my colleague, Senator Moynihan in the Senate, in not only passing that landmark welfare reform measure, but in the process teaching the country a set of lessons and providing a set of insights about the relationship between public assistance and entry level jobs and the dilemma facing the working poor.

When the bill finally passed, as you know, it turned out to be practically and politically impossible in the circumstances that prevailed in the last Congress to get the full measure of reform, which this subcommittee and Senator Moynihan recommended.

Consequently, the bill represents an enormous step forward and an enormous improvement. But it still leaves in place some of the work disincentives which the subcommittee identified for the country and the solutions for which were pointed out for the country.

We know what to do. Back when the war on poverty was launched 20 years ago, we were experimenting and some of those experiments were successful, some were not.

But we've learned so much since then and yet we still have a kind of crisis of confidence in whether or not we can really grapple with this problem.

I think we know what to do. Welfare reform is a key part of it. Incentives to get on the work rolls is the other key part of it.

Mrs. KENNELLY. Well, Senator, I think I know what to do and you know what to do and Tom Downey knows what to do, but I'm trying to make it a little clearer—I got here late. Did you mention a figure—did you give a figure on the funding mechanism?

Senator GORE. I have materials which I will put into the record with permission.

Acting Chairman DOWNEY. Without objection.

Senator GORE. Which gives the cost of the program and shows how we recommend the program be financed. We completely pay for it in the legislation and also reduce the deficit by $5 billion. But again, the financing mechanism we've recommended is subject to review and if the subcommittee or full committee either here or in the Senate has other suggestions, I for one have an open mind.

Mrs. KENNELLY. What I'm after is—I just wonder, Senator, since we cut so short—cut back to the extent we did with welfare reform,

are we ready to move on to the next step? The Congressman just mentioned entry level wages and more if a person is really going to live with any dignity.

I just wonder if you feel comfortable that we are ready to go this step before we even have this year's funds for welfare reform, since what was legislated last year for welfare reform is not in the budget.

Senator GORE. Yes, this is needed—I would argue that this is needed whether or not the welfare reform measure is fully implemented.

I support that measure just as strongly. It's greatly needed. It's the other half of the puzzle: how do we make sure that people have incentives to go back to work when the opportunities are available? But regardless of what happens there, this bill ought to be passed. It is the single most effective measure to deal with poverty.

Mrs. KENNELLY. But I think you're getting to where I'm going. Can we differentiate between those that are trying very desperately to get off welfare and the working poor who are out there working? What I see is kind of a meshing of these two groups and as we go along we'll be able to keep the differences.

My question is, will the emphasis be on the working poor to keep them from going on welfare? Or will the emphasis be still trying to get people into a living——

Senator GORE. The emphasis is on both and by focusing on the broad economic incentives which people on welfare trying to get off welfare have, and they're the same incentives that people who are working at the minimum wage and trying to do better have, by focusing on those broad economic incentives, we affect the choices available to both groups.

We pay particular attention to parents with young children who need child care, but we focus on those who are on both sides of the line, receiving public assistance and trying to get on the work rolls, people who are already on the work rolls and are trying desperately to pay for child care and to get ahead.

We help both groups and move both groups into a better standard of living.

Mrs. KENNELLY. Thank you, Senator.

Acting Chairman DOWNEY. Mr. Sundquist.

Mr. SUNDQUIST. Thank you, Mr. Chairman. Welcome, my friend and colleague, Senator Gore, back home.

Senator GORE. Good to be here and good to see you on this Subcommittee.

Mr. SUNDQUIST. Well, it's good to be here. I commend you on your work. I don't think there's any question that we are all trying to solve the same issues. It's a matter of what course we take. I frankly have an open mind on where we ought to head.

I appreciate your testimony today and am glad to get the benefit of your experience. I've been in some of the same counties as you have and I'm getting the same thing from our constituents, particularly the working poor. They're saying why work if the difference between working and being poor is so little compared with those who are on welfare. So we're losing that incentive and we stand a chance of creating another generation of people who depend on welfare.

Would you comment on the pluses and the minuses of expanding the earned income tax credit and of targeting all our money on the tax credit rather than spending money on child care? In other words, shouldn't we help a family of four, for instance, that desperately needs more money than they can get from the minimum wage. If we raise minimum wage we're going to put thousands of people out of work. So wouldn't they be better off with a big tax credit than a subsidy on child care?

Senator GORE. Well, again, we're not advancing this proposal as a substitute for an increase in the minimum wage or as a substitute for measures to improve the standards that are followed in day care centers and assistance for day care by other mechanisms.

We believe this is the single most effective approach, but we don't put it forward as a competitor or as an alternative to other very sound measures that have been introduced.

I personally believe that the earned income tax credit expansion and the provision to make it sensitive to family size, along with the provision to expand the dependent care credit and make it refundable—these provisions, I believe, are the most effective ways to deal with the underlying problem.

You mentioned that some of our constituents in west Tennessee see a very little difference between going to work and staying on welfare.

The difference sometimes is negative. In other words, they are actually better off staying on public assistance if their children need health care. If they have other benefits that will be canceled if they go to work, then the benefit is negative.

Welfare reform can continue to address that discrepancy, but, as I said a moment ago, regardless of how far we get in welfare reform, this measure will address those same discrepancies.

I will provide, or perhaps it is available in the materials that the subcommittee has already. There is a chart that really more clearly than anything else demonstrates exactly what the practical impact is. And rather than read these numbers off, I'll just provide a copy to you that shows what happens if a family is making, say, $10,000 a year. I use this example in my testimony. Under current law, next year they will get $953 from the earned income tax credit. Under the bill they would get $2,000. From the dependent care credit they would get—well, if they had two or more children they would get zero from the dependent care credit.

They are making $10,000 a year. They've got two kids that need child care. With this program that is on the books that is supposed to help them with child care expenses, they get zero from it.

Whereas somebody that's making twice as much would get $1,000 for their child care expenses. That doesn't make sense. That tells that person that they are not being treated fairly.

Under the bill, the same family would get $1,200 for their child care expenses.

So I think for those and other reasons it's the most effective way to proceed.

Mr. SUNDQUIST. My colleague, Tom Petri, is going to be testifying and he is a strong proponent of a wage supplement program. Would you comment on that?

Senator GORE. Well, you can use different names and different designs for a similar concept. I'm not going to comment on the details of his proposal. I'll let him do that, but if you look at this same chart, you'll see that a family getting—earning only $2,000 a year with two or more children, would get $600 from the earned income tax credit. And so, in a sense that is a wage supplement. We don't call it that and what we do does not require any new administrative program, any new administrative expense. It's grafted on to a program that's already up and running. We know how to do it. We know how to implement it and it's cheap to do in that aspect.

The cost of providing the assistance, again, is paid for in the bill.

Mr. SUNDQUIST. It seems to me that we've got to get more money into the hands of people who are trying to make it by working so that there is incentive to move off or avoid welfare. I appreciate your testimony today.

Senator GORE. Thank you very much.

Mr. SUNDQUIST. Thank you, Mr. Chairman.

Acting Chairman DOWNEY. Thank you, Senator Gore, and again, thank you for your leadership on this issue.

Senator GORE. Thank you.

Acting Chairman DOWNEY. The subcommittee will next hear from our colleagues in the order that they appear. If they would all come to the table. Congressman George Miller from California will be heard first, Congressman Petri of Wisconsin, and then Congressman Henry.

If you would all come up to the table. We're expecting Congressman Tauke. He is in route and when he arrives he will be seated at the table.

Congressman Miller, I personally appreciate the fact that you are one of the original sponsors of the legislation that Senator Gore and I have introduced along with Congressman Lewis, and without gilding the lily too much, we also deeply appreciate the work you've done as chairman of the Select Committee on Children, Youth, and Families.

We're delighted to hear your testimony today.

STATEMENT OF HON. GEORGE MILLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHARMAN, SELECT COMMITTEE ON CHILDREN, YOUTH, AND FAMILIES

Mr. MILLER. Thank you, Mr. Chairman. I, unfortunately, am going to have to be somewhat brief in my appearance here. I don't know if that's unfortunate for you or me, but I have to go to House Administration to present the committee budget and I don't want to miss that opportunity.

Mr. Chairman, and members of the committee, I want to thank you for this opportunity and tell you that this morning's testimony is in fact a logical followup to what this committee did last year in and its endeavor to redesign the welfare programs in this country so that we place a premium on people gaining the skills they need to go out and take a chance on the free enterprise system.

Once they are out there, once they get the training and/or the education, we also, have to place that same incentive on their staying in the work force.

A number of years ago, we cut the tax rates in this country on the theory that if people could keep more of the money that they earned they would work harder, they would have a greater incentive to work, and to invest in risk capital.

The same goes true for poor families. If they have the idea that they are going to keep money for the fruits of their labor, they are *going to stay in the work force longer.* And, in fact, if they can benefit by being in the work force, we know that they will go out, that they desire to.

Poll after poll of poor people indicates that what they really want to do is work, but we also know that there are a number of obstacles placed in their way. Some of them are created by the Government.

The notion that all of us are here to testify on—your bill, Mr. Petri's bill, and others—is designed to remove some of those obstacles and certainly to deal with the least involvement of the Government.

Some people suggest that poor people are poor because they just don't work enough hours. Well, as I understand it, to earn about $24,000 a year, they'd have to work 120 hours week. If you think there is tension in families now, try that one on for size.

I think what we've got to understand is that we now have in this country maybe 20 million children and their parents who are living in poverty, and in fact, somebody in that family is working.

In my State of California, 52 percent of our 2 million children in poverty live in two-parent families and in most of those households somebody is working. That's what we said we want in America.

We said we want an intact family that is out there working, trying to provide for the needs of their family. The fact is, obviously, as you've heard from Senator Gore and as the bill addresses, and you'll hear later, is it doesn't do that. You arrive at a point where, as has been testified in our committee, the difference between working and not working is that if you work you get "soup beans, and taters, and if you're on welfare, you get taters and soup beans."

That cannot be the distinction between public assistance and work in the United States of America. That simply cannot be our policy.

And yet, we know that living at the margin are millions of families. The things that we take to be ordinary events in our life, ordinary events—a dead battery. What do you do? You call AAA? You call the Sergeant at Arms? You call the highway patrol depending on where you are. You say, "I've got a dead battery and I'm on my way to a meeting." They lose their jobs. They lose a day's pay because at that level of work people don't much care about your excuses and there is somebody waiting for your job.

We have to understand that what you then create in working poor families is such a tension between the work place and trying to keep your family together, that what you do is you finally, I think, get exhausted and you decide that welfare is a logical alternative.

It reduces those pressures. It puts your kids back in the situation where you can see them, you can deal with them, you can be with them. And the rewards simply aren't out there.

The Downey bill says we're going to reward you for taking a risk on our economic system. And I think it's very important that we understand that that's really the bottom line.

We've got to understand that those tensions are real. Mrs. Kennelly raised the point, are we ready for this bill and yet we don't fund the budget. This subcommittee has got to fight for full funding of welfare reform.

These are two populations, but hopefully they will end up being one, and that is, they will end up being a working population. But we have got to provide quality day care. We have to provide quality job training so that people can take their place who don't have those skills.

We found out in California when we engaged in welfare reform, we engaged in the whole work incentive program, what was it? Almost 48 or 50 percent of the people could not fill out a job application.

This bill is not going to help them. You have to consider this a partnership. We have to have a continuum in our system that continues to place a premium on our economic system.

And I think that we also have to understand that all of the indicators in the Select Committee after 5 years of testimony and traveling this country and meeting with your constituents and listening to them indicates this problem is getting worse and that more and more families are at risk.

I want to echo the sentiments. This is not a substitute for raising the minimum wage. We just had a hefty raise in the minimum wage in the state of California and we still have "work wanted" signs, but we still have people who decide it's still not in their interests.

We need a combination of these programs. And if you think that this is a substitute for child care standards and safety and health regulations, you're badly mistaken.

This last Friday I visited the Martinez Child Development Center. It happens to be in my hometown. I talked to a young woman there. I was talking to her about her child. I said, "What are you doing," and she says, "I'm going to Diablo Valley College." I said, "What were you doing before," she said, "I was hanging out on welfare." I said, "Why were you doing that," she says, "I was waiting to get in here because this is a program that provides the kind of program I wanted for my kid. I wanted my kid to have activities and other programs didn't offer that."

She's now on her second year of her registered nursing course and it's a 3-year course.

Parents make these distinctions just like you do. Because you're poor doesn't mean that you don't care about your kid. Because you're poor doesn't mean you don't care about your paycheck. Because you're poor doesn't mean you don't care about your health care.

And what we're seeing while we've generated an incredible number of jobs in this country, is they don't all bring the package

of benefits or the economic rewards that we would want for our own family.

And you don't change your thinking on that process simply because you happen to be poor.

This is an opportunity, I think combined with an increase in the minimum wage, combined with quality child care and the availability, combined with title XX, that for the first time I think you can go home to your constituents and say that you're designing a program that from the outset is designed to work and designed to help people stay in the American economic system.

That's what we say we want. That's what we say in our campaign speeches. That's what we tell people in our town hall meetings; that that's our goal and we have to start now removing those impediments and recognizing, I think, really recognizing the dignity of these families.

I've had hearings in the Select Committee of families from the District of Columbia who are working poor. I mean that's a horrible term, "working poor." And they tell you how they go through their daily activities. I'll tell you what, they've got a hell of a lot more courage in getting up every morning than most of us do because their obstacles from the moment they get up are far greater than we realize in months and years of our daily lives.

And again, they are ordinary little things that become catastrophic events, catastrophic events and you know that—you can just see the exhaustion in these people's faces when they testify to you.

And yet, they are staying with us. They are going out and working, but they are simply not able to make ends meet. They are simply not able to make ends meet in terms of food, or rent, or shelter, or the care of their children.

Finally, I have got to tell you this, if we don't do this, if we don't send a message that there is a benefit in working and that there is a benefit in working even if you decide to get married, and that there is a benefit in working if you decide to get married and you decide to have children, we're in serious trouble. Because the direction in many, many of our communities across this country is exactly the opposite.

There is no reason to get married because if you start looking for eligible men in a number of the minority communities there is no one there you would marry. It is not logical.

There is no reason to stick around and take care of your kids because you can't provide for them even if you go to work. And that's the message that is being sent. And that is what causes communities to disintegrate. That's what causes families to disintegrate. And that's what causes people to lose a stake and an interest in American society.

I don't think it's too far of a jump from that attitude, our failure to reward, and the violence in society. And I think we've got to think about what are the tools.

We're of a mind where still people don't want to engage in large governmental programs, and that's understandable. Then we had damned well better get some resources to these families that are in trouble because otherwise the signals that we are sending to 15 year olds and 16 year olds is, "it's not worth it." Don't think about

marriage. Don't think about stability. There is no reward in it. You're a fool. You're a fool on the street if you go out and participate in that system.

It just doesn't make sense and that cannot be what the Congress of the United States is about. I think the fact is that this bill is not cheap. It's not cheap, but unfortunately we've created so many poor people that it will never be cheap no matter how we deal with it, but it's the answer.

It's the answer in combination with quality child care, with the assurances that your child is safe, with health care benefits, and with job training. Then we have an opportunity to say, you're a damned fool if you don't work in this country and that has to be the message to people in communities.

Thank you very much and I'd be delighted to answer a quick question. Again, I ask your patience for the fact that I cannot stay.

[The statement of Mr. Miller follows:]

The Honorable George Miller
Chairman
Select Committee on Children, Youth, and Families

Testimony before the Subcommittee on Human Resources
Committee on Ways and Means

"Problems of the Working Poor"
February 28, 1989

I appreciate the opportunity to testify today before the Subcommittee on Human Resources and I commend Acting Chairman Downey for his leadership on the working poor. Over the last six years, the Select Committee on Children, Youth, and Families, which I chair, has heard from scores of working families who, despite a willingness to work hard, remain poor. Nearly 20 million American children and their parents -- more than half of the entire poverty population -- live in families where an adult works but the family is still poor, an increase of 40 percent over 1979. These families live every day at the economic margins. Minor incidents like the car breaking down or the babysitter not showing up can mean lost work days, lost wages, and lost jobs.

Janice Haynes, the single parent of a young boy with muscular dystrophy, lost her job at a VA medical center in Columbus, Ohio when her car broke down and she could find no other means of transportation to make the 40 mile trip to work.

When her daughter needed emergency medical attention, Josephine Yanchak lost two days of work and two days pay from her job in a small factory. She had to borrow money to pay her family's rent that month.

Joan Rhones told the Select Committee how difficult it was to afford a babysitter on her small salary. She was forced to leave her four children alone during the day while she worked.

Viola Waldo works as a child care worker in West Haven, CT. Her husband drives a truck and works weekends in an auto parts store. Viola's employer offers a medical plan, but she must pay the full cost of insurance. The family spends almost 20 percent of its family income on medical insurance.

These families are not statistical blips but a growing anomoly of the economic prosperity of the past six years. While the economy has created jobs for millions of new entrants into the labor force -- many of them mothers -- it has often failed to increase the economic security of those new workers and their children. The Department of Labor's Bureau of Labor Statistics estimates that five of the top ten expanding jobs -- cashier, food service worker, hospital aide, janitor, and retail sales clerk -- pay below poverty wages.

Wage rates that have failed to keep pace with inflation have jeapardized the economic security of children and families. The federal minimum wage has lost one-fourth of its value since 1979 and no longer lifts families of any size above the poverty level. And while income for all families have registered real increases, among low-income families with children, family income has dropped 22 percent for the poorest families and 3 percent for the next poorest.

In addition, the rising cost of basic family obligations, has made it far more difficult for families to feed, house, protect, and educate their children than just a generation

ago. Home ownership rates have declined dramatically, while rent burdens for low-income families have increased to almost 50 percent of family income. 75 percent of the 37 million persons without health insurance reside in working poor families, while children of working parents comprise the fastest growing group of persons without health care protection. Child care costs, the newest major expense for working families, consumes up to 26 percent of the incomes of poor families.

Many Americas who are seriously concerned about the status of America's children are shocked to discover the extent of impoverishment among the working poor. First Lady Barbara Bush recently visited a community outreach center in Alexandria, Virginia and she was shocked to discover that 70 percent of the children and families who received child care, food, and medical assistance from the center are members of working poor families. In California, more than half of the million children who go hungry every night live in families where one or both parents are working. And public campgrounds, once thought of as family vacation sites, have become home to increasing numbers of poor families who work seasonally in the construction industry. Nationally, it is estimated that at least one-third of all homeless families have a working parent.

Last year, we passed a welfare reform law that emphasized work as the key to economic security. The CBO reports that this approach will lift less than one percent of welfare recipients off the rolls because work, even hard work, is no longer a ticket out of poverty. In fact, in many states, a family does better not working and collecting AFDC and Food Stamps. As Lynn Hudson, a working poor mother, testified before the Select Committee last year, "the only difference between working and not working is you can have soup beans and taters if you work, and if you're on welfare, you can have taters and soup beans."

When parents like Lynn Hudson are willing to work hard, Congressional leaders and business executives have a responsibility to ensure that those efforts will pay off. Working poor families need more money. It's that simple. In the 1960s and 1970s, the minimum wage provided a wage floor that kept most families out of poverty. In the absence of federal action, since 1981, 15 states, including California, have raised the minimum wage. And despite the warnings of the business community, there is no indication that jobs have been lost as a result. If we are truly sincere in our desires to reduce the problems of the working poor, raising the minimum is a crucial first step.

But raising the minimum wage alone is not enough. I am proud to be a co-sponsor of H.R. 882, the Employment Incentive Acts, along with Acting Chairman Downey, Senator Al Gore, and Congressman John Lewis. The Employment Incentive Act is predicated on a simple proposition -- the more you work, the more you benefit. It is designed to enable working poor and near-poor families to keep more of their earnings and will help 1.6 million working Americans climb out of poverty.

Our bill does three things. First it improves the existing Earned Income Tax Credit (EITC) by expanding it and adjusting it by family size, thus allowing workers to receive a larger tax rebate to supplement low wages. Second, it reduces the costs of child care to the working poor by making the existing dependent care tax credit refundable, as President Bush has also proposed, and by increasing the average amount of this credit available to low-income families. Finally, the bill increases funding for Title XX,

the Social Services Block Grant, to ensure that States have sufficient resources for assisting the poorest of working families with especially high child care expenses.

The combined effect of the EITC and dependent care provisions will be significant. For a family with two children earning $10,000, the Employment Incentive Act will increase family income by $3,243 annually, an increase of $2,290 over current law.

This approach will stimulate additional work opportunities without creating costly programs, and it will help keep families on the job rolls and off the welfare rolls.

Increasing the minimum wage and modifying the tax code to enable working poor families to keep more of their earnings are significant steps in reducing poverty among working families and their children. But as we learned in welfare reform, in order to make work preferable to welfare, employers and policymakers must ensure that working families and their children have health care protection as well as adequate and affordable child care. We went to great pains to ensure that Medicaid and child care subsidies were made available to AFDC parents during the transition from welfare to work. When the one year transition is over, however, the graduates of welfare reform will take on the characteristics of the working poor: working in low-wage jobs with no health benefits or child care. If we are serious about making work more attractive than welfare, then we must responsibly address the problems of health care access and the crisis in child care quality and supply.

The Employment Incentive Act, together with raising the minimum wage, and ensuring the availability of quality services in transportation, child care, and health care, would dramatically improve the rewards from working. Lynn Hudson, Joan Rhone, Viola Waldo, and the other 20 million members of the working poor want to make it on their own. Let's give them the tools to do so.

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Acting Chairman DOWNEY. Surely, George. I think that—first of all, thank you for your very powerful and persuasive testimony.

I want to just develop one point with you and it's the same question that I put to Senator Gore.

There is no doubt in your mind that being poor—and I think you've addressed the extraordinary tensions that exist in the family that causes families to break up—is further evidence of causal connection between violence and many of the other fissures that we see in society.

Mr. MILLER. There is no question in my mind. I mean you visit shelters and talk to people who are in shelters. The book, "Rachel and Her Children," if you look at many of these families that are in shelters, they were working before they were in a shelter. They had a job. For one reason or another, they had a job and they lost that income.

And the people who leave their families, we saw it. We saw it in the strongest areas of this country, when we downsized the steel industry, when we changed the coal mining industry, these were the bedrock of American families.

They lived in Pennsylvania. They lived in Kentucky. They lived in Illinois. They went to work every day. They walked down to the mill. And when that came apart they started beating their families. They saw alcoholism rise. They saw men beat their families. We saw violence and we know now the connection between the economic stability in a family and family violence and substance abuse.

We can track it on a chart like you can track interest rates. You start throwing people out of work and the hot lines in the crisis center and the child abuse center and the family violence center, the alcoholic abuse and substance abuse center immediately start lighting up.

Those were supposedly our strongest families. They had extended families in neighborhoods. They lived together. They had all of those resources.

But once the economic under pinnings were pulled out from under those families, they started to crack just like everybody else. And if you live on that without even the hope of moving up to that level, I think you have got to appreciate the tension that it creates.

You have got to go out and talk to these people and see the kind of tension that they live under. I mean they get up every day and they drive miles to these jobs because that's what they believe they're supposed to be doing.

And yet, we're in a sense—you know up until welfare reform we were actually punishing them. We were taxing them. Until tax reform we were taxing them back into poverty. Fortunately we've gotten away from some of that and you've lifted people out of poverty with welfare reform and you have another almost 2 million people that you can get out of poverty so that at the end of the year they can turn back and say, at least I'm not poor. I'm working hard, but I'm not poor. Last year I was working hard and I was still poor.

That tension is very real in these families. It's probably even real in congressional families.

Mr. SHAW. I have no questions, George. I know you're supposed to be somewhere else. I'd like to thank you for very powerful testimony. I think what you're saying is absolutely right. I hope together we can craft something that will help poor and low-income working families.

Acting Chairman DOWNEY. George, you're dismissed. Thank you very much.

Mr. MILLER. Thank you. I've got to run, but I have another comment.

This bill is absolutely in keeping with this committee because in all your discussions in the tax committee what you're really doing is saying whether or not you're willing to risk some of the nation's resources in venture capital and make an investment. And that's what you're doing here.

You're really going to decide whether or not you're going to risk $30 to $40 billion on the human capital in this country and are we going to have the courage of somebody who starts an Apple Computer or super conductivity, or any of these issues, are we going to have the same kind of courage and the faith in the American people that we are willing to invest a little bit of venture capital on their behalf to see whether or not they can become part of American society.

Thank you.

Acting Chairman DOWNEY. Thank you.

The committee will next hear from our friend and colleague from Wisconsin, Mr. Petri, and we take notice of your leadership in this matter.

You have your own legislation and have been an articulate and persuasive spokesperson on behalf of the earned income tax credit and we welcome that.

STATEMENT OF HON. THOMAS E. PETRI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. PETRI. Thank you. I think you're a bit generous and kind, but I appreciate it and I also want to very seriously and sincerely commend you and Senator Gore and George Miller and the other co-sponsors of your legislation for your initiative and for having this hearing, and for taking this issue up, and I hope carrying it forward.

We differ on a variety of details, but I think we—I certainly agree with everything that I heard Mr. Miller say so far as the problem we're trying to deal with and the need to get incentives in line, and Senator Gore as well.

I am very pleased to have the opportunity to be here today on this occasion.

At the outset, let me state my agreement, as I said, that people should be able to make more money working than they can receive on welfare. Beyond that, it would be nice if no one who worked was poor, but that's obviously a more ambitious goal.

I'd like to discuss briefly the nature of the basic problem I think this hearing is meant to address, and then outline some general principles for addressing it.

The basic problem is that economic need and therefore welfare payments vary by family size, but work skills and therefore wages do not. Our official definition of poverty, the so called poverty line, starts out at about $5,500 annual income for a single person and adds about $1,900 more for each additional member of the family. Basic AFDC and food stamp benefits are also geared to the number of people in the family, but generally provide somewhat less than a poverty level income. In my own state of Wisconsin, last year these benefits amounted to $8,004 for a three person family versus the poverty line of about $9,300; $9,576 in benefits for a four person family versus a poverty line of about $11,200; and $10,980 for a five person family versus a poverty line of $13,000.

Now consider how various types of family incomes compare to these poverty levels if the bread winners work at low wage jobs. A full time job at the current minimum wage pays $6,968 per year, minus Social Security taxes of $523, for a net of $6,445. So even such a low paying job puts a single person almost $1,000 over the poverty line.

Now next consider two person households. Their poverty line is about $7,400 in annual income. Both persons are adults. There is the potential for two incomes and the household is likely to be far from poor. If the household consists of a single parent with one child, the parent is eligible to receive about $900 from the current law earned income tax credit this year, bringing her or her net income from even a minimum wage job to within about $50 of the poverty line for two people. Since labor market forces in most parts of the country are pulling wages above the federally mandated minimum, even for very low skilled workers with little experience, in general we can say that working single parents of only one child are not poor either, at least according to the official definition.

The real problem of disparity is between earnings from low skilled jobs and welfare payments or poverty level income occurs in larger families; single parent families with two or more children and two-parent families with three or more children. The larger the family, the worse the problem.

Exclusive of child care costs, a Wisconsin single mother of two, working full time at the minimum wage, would take home after figuring in her earned income tax credit about $650 less per year than she could get from AFDC and food stamps and about $1,950 less than the poverty level for her family. If she had three children, she'd make about $2,200 less than on welfare, and $3,850 less than the poverty level. If she had four children, she'd make about $3,600 less than on welfare, and $5,750 less than the poverty level. Put another way, to match AFDC and food stamp benefits, she'd have to earn $3.70 per hour if she had two children, instead of the minimum of $3.35; $4.53 an hour if she had three children; and $5.29 an hour if she had four. To reach the poverty level she'd have to make $4.40, $5.43, and $6.46 per hour in the three cases respectively.

Well, Mr. Chairman, both you and I have recently introduced bills designed to alleviate these problems through direct wage supplements varied according to economic need and achieved by adjusting the current income tax credit for the number of children in the family. And as I said, I think your bill is an important step in

the right direction and I hope you hold a similar view about mine. As the Ways and Means Committee considers these issues further and moves toward final legislation, as I hope you will, I suggest that it apply several basic principles.

First, because the basic problem is greatest for larger families, any adjustment of the EITC for family size should not stop at two children. Of the 34 million families with any children in our country, almost 8 million have three or more. These are the families that need the most help. Their poverty lines are highest and they make up a disproportionate share of the families caught in welfare traps or fitting the description "working but still poor". In order to cover most of these families more adequately, we ought to provide additional EITC amounts per child for up to at least four children, rather than two.

Second, I think it would be better policy to focus all available dollars on expanding EITC amounts rather than spending any on the dependent care credit. In the first place, most very low income workers simply do not pay large amounts for child care, if they pay anything at all. They don't have the money. So derive little benefit from the dependent care credit. The vast majority of them would be better off if the same dollars were distributed through the EITC instead.

In the second place, I would argue that it is fair to provide health for people with children independent of whether or not the parents pay someone else for child care services. The need to look after these children poses an economic cost on someone, often in the form of, regardless of whether dollars change hands. It seems to me that society through the tax code should be neutral as to the form of care provided rather than subsidizing only one kind and forcing parents into paid care in order to reap benefits.

We may have trouble providing sufficient EITC increments per child to provide substantial help to those low-income parents who do have to pay others large sums for child care. As a compromise, I suggest providing increments for pre-school children that are twice as great as thoser for school age children. While there are many different costs associated with raising all children, the need to look after them is surely one of the largest—and it is far larger for pre-schoolers. On those grounds, a larger wage supplement for pre-school and for school age children can well be justified.

If we follow these basic principles I think we can come up with a strong wage supplement program that enables far more people to make more working than they could receive on welfare and that brings many of them over the poverty line.

Within the dollars likely to be available, I am not sure that we will be able to accomplish these two goals for everyone, but it will go a long way in that direction.

In fact, I would like to think of this, and I think you do too, as welfare reform around two. It moves toward the principle that everyone's basic source of income should be whatever he or she can earn by working, and then if society decides it is not enough, society should supplement those earnings directly according to need as determined by family size.

In this respect I would like to leave you with one final thought. Insofar as this kind of policy should help some people to move off

welfare wholly or in part and into the labor force, it should enable us to reap significant welfare cost savings. However, as you know the Congressional Budget Office is reluctant to score any such savings for budget purposes. It seems to me that it is in the interest of all of us who are working for such policies to keep working on coming up with some kind of basis on which their true budget effects can be more realistically scored. And that will in turn give us more budget dollars to work with in our attempts to help the working poor.

And, in that connection, I think we should count these EITC dollars that we are sending to people as income for purposes of kicking in the work requirement on welfare. That is legal tender. It is counted for Federal budget purposes when it goes out as money, and it should count as money when people receive it and spend it, and that would help us realize these welfare savings.

Acting Chairman DOWNEY. Thank you, Mr. Petri.

Can I ask you what is the cost of your bill?

Mr. PETRI. Three billion dollars we figure not counting any welfare savings. And, that is——

Acting Chairman DOWNEY. Total?

Mr. PETRI. Total.

Acting Chairman DOWNEY. One year?

Mr. PETRI. Yes.

Acting Chairman DOWNEY. Do you have a mechanism to pay for it in the bill?

Mr. PETRI. We—yes, in part. It is actually $7 billion stream of income to working poor people. Four billion is taken by eliminating the current child care credit, and refocusing it as earned income credit. We give it up to $45,000.

So, it actually is the same—it is progressive tax policy in the same way that yours is. You accomplish the revenue by increasing the base rates. We do it by taking the child care credit away from the—God Bless them—the Rockefellers and others who are currently qualified for it, but really do not need it.

So, rather than increasing their rates, we focus this credit on up to about $45,000 income.

Acting Chairman DOWNEY. But, that does not pay for it entirely?

Mr. PETRI. That pays for a majority of it.

Acting Chairman DOWNEY. It does?

Mr. PETRI. Now, we also—we are not sure what the Administration's policy is going to be in the child care area, but as you know the President did support in his campaign a program in the $1½ to $2½ billion range.

And our whole program, which is EITC and child care, would have a $3 billion cost. So we figure that if you count what you might spend in the child care area and focus it through this EITC approach—one other thing—this really should be coordinated, in my own opinion, with an increase in the minimum wage.

Not to say that there shouldn't be one, but that we should coordinate policy in this area and we did get a scoring from Barrel Sprinkle at the Council of Economic Advisers last year that the $4.65 increase of the minimum wage when fully implemented would result in a budget deficit increase of $2 to $6 billion.

Now as time has gone by and inflation has probably reduced that somewhat, but there will be some—and you maybe could pick up a little by coordinating minimum wage increase with child care and EITC.

It's all money for the same people and if they coordinate it in their minds when they are figuring out their incentives, then we ought to be coordinated when we set policy.

Acting Chairman DOWNEY. You have in your proposal to adjust the EITC for four family sizes and then adjust it if children are preschool age or not.

Mr. PETRI. Right.

Acting Chairman DOWNEY. And my concern is that——

Mr. PETRI. We save some too by going up to age 16 rather than older. And the reason for that—I mean this is not a perfect world. We can't give everything unlimited to everyone and we felt that was a reasonable line to draw because under the Fair Labor Standards Act, 16 is the time in which someone can have a full time job in the United States and so presumably an awful lot of kids, teenagers, will be working or could work and supplement the family income to some extent. So it seemed a logical cutoff for this.

Acting Chairman DOWNEY. My question is whether or not it doesn't make the law more complex and make it more difficult for the Internal Revenue Service to administer. Do you have any thoughts on that?

Mr. PETRI. I would only say this, that they have to administer child care deductions now under the Tax Code and I had to fill one out, you had—we all do, and change it every so often for our employer to vary the withholding——

Acting Chairman DOWNEY. True.

Mr. PETRI. And this is really that same mechanism. It would have to be—would require some additional form presumably to be filled out by—well, maybe not because if some is applying it for one, they would have to indicate there that they were applying and then how many dependents. So——

Acting Chairman DOWNEY. Yes, but first we'd have to figure out which of the four levels of EITC they got, then we'd have to have some determination of who is in school and who isn't in school.

Mr. PETRI. Well, age, they would do it by age. You'd have to—if you have kids under 6.

Acting Chairman DOWNEY. OK, by age. It seems to me that—it adds a level of complexity.

Mr. PETRI. That's true.

Acting Chairman DOWNEY. The thrust, as I stated before, is one we warmly welcome and I thank you for your testimony.

Acting Chairman DOWNEY. Mr. Shaw.

Mr. SHAW. No questions.

Acting Chairman DOWNEY. Mr. Coyne.

Mr. COYNE. I have no questions.

Acting Chairman DOWNEY. Mr. Sundquist.

[Negative response.]

Acting Chairman DOWNEY. Thank you, Tom.

Next the subcommittee will hear from Mr. Henry, a Member of Congress and a friend from Michigan.

STATEMENT OF HON. PAUL B. HENRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. HENRY. Well, thank you, Mr. Chairman. I want to thank you and the subcommittee for holding this hearing and for focusing early attention this session on the issue of low income working families, and for inviting me to testify.

I also want to commend the chairman directly for introducing this legislation, which combines the earned income tax credit and refundable child care tax credit ideas along with additional funding for title XX, and I am pleased to be, as you know, a cosponsor of your bill.

I suspect that all of us who have looked at this issue of family incomes and income disparities have been struck particularly by the extent to which our children disproportionately are growing up in families at the lowest ends of the income scale. It is estimated that nearly one out of every four young children living in families now live in families below the poverty line.

Eluding to Mr. Miller's remarks earlier, even children of homeless families, 30 percent of those children have at least one working parent.

Younger families, those with young children, appear to be particularly lagging in terms of the general growth and family income during this decade.

The number of children living in poor families obviously has and has had, and continues to have a major impact on our educational institutions and other social ramifications.

The last Congress cumulated years of effort in passing significant reforms of the welfare system. I concur with your statement earlier this year that it is appropriate to focus now on low income working families as one of our top priorities.

My colleagues on the Education and Labor Committee, Tom Petri and Tom Tauke, have done a tremendous amount of work on our side of the aisle relative to the current income tax credit and a refundable child care credit.

They in many respects, along with Mrs. Johnson on your subcommittee, are experts on these issues and I look to your bill as helping us lay the ground work for considering these issues in what I hope will be a bipartisan effort to enact changes in these programs this year.

I recognize that there are differences in the details among the various proposals, particularly with regard to the child care tax credit, but rather than repeat the arguments made over those particulars, let me speak generally to the policy guidelines which I believe we ought to follow in increasing assistance to low income families, which have led me to cosponsor your bill, and which I think are also shared in proposals by Mr. Tauke and Mr. Petri.

I think that's the significance of this hearing in part in terms of what is beginning to represent a convergence of some concerns here.

First, we ought to encourage choice and flexibility for families. Parents rather than state governments should be given the resources to choose, for example, child care arrangements best suited for their situation.

I commend the Chairman for introducing legislation which for the most part puts the additional resources directly into the hands and pocketbooks of families and does not seek to restrict the providers to which these families can turn.

As we saw in last year's debate on child care legislation, restricting providers ends up increasing costs as well as potentially eliminating the most popular types of providers, families, and religious day care centers.

Second, to the extent possible, additional Government resources ought to be distributed through making changes and building on existing programs, rather than initiating new Federal programs, which take years to put into place and to work out all the kinks and the bugs, as Senator Gore indicated in his earlier testimony.

Again, I commend you for adopting an approach which builds on existing programs and delivery systems. Beginning a new Government program is always an attractive temptation for us even when we know that there are few resources to pay for them, and most of those that can be allocated simply go to setting up an administrative mechanism.

Third, we ought to use the private sector rather than working at cross-purposes with it. We all acknowledge the benefits of work. In theory, we all agree that work should be rewarded. But in fact, too often Government policies tend to have the opposite impact and we need to encourage and assist these low income families who are attempting to maintain their income level and improve it by working.

The tax credit approach encourages and assists working families and does so without Government mandates, which end up discouraging employment.

These three broad principles I think are very key—encouraging choice and flexibility, utilizing existing mechanisms, and working in conjunction rather than against the private sector.

I think all three of the various proposals, and yours clearly every bit as much, is true to those principles.

One of the chief challenges of our economic systems is maintaining a balance between economic growth and economic justice.

We have tended in our public policies to shift rather dramatically as a pendulum back and forth from one emphasis to the other, from pursuing equitable distribution of resources to such an extent that it interferes with incentives necessary to produce economic growth, or on the other hand, to following policies which encourage growth, but ignore those struggling to join the economic mainstream.

Our challenge is to maintain economic growth, while helping those at the bottom of the economic ladder. And I believe that the best way to do that is by putting additional resources into the hands directly of those families to help them pay for some of the costs associated with working.

I commend and support the direction of your efforts.

[The statement of Mr. Henry follows:]

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TESTIMONY BEFORE SUBCOMMITTEE ON HUMAN RESOURCES

February 28, 1989

I want to thank the Chairman and the Subcommittee for holding this hearing focusing attention early in this session on the issue of low income working families and for inviting me to testify.

I also want to commend the Chairman for introducing legislation combining the Earned Income Tax Credit and refundable child care tax credit ideas, along with additional funding for Title XX. I am pleased to be a cosponsor of your bill.

I suspect that all of us who have looked at this issue of family incomes and income disparities have been struck particularly by the extent to which our children, disproportionately, are growing up in families at the lowest ends of the income scale. Nearly 1 out of 4 young children live in families below the poverty line. Younger families, those with young children, appear to be particularly lagging in terms of the general growth in family income during this decade. Given the work that Congress, and this Subcommittee did in the last Congress on reforming the welfare system, I believe that the issue of low income working families should be one of the top priorities in terms of any additional resources this year.

My colleagues on the Education and Labor Committee, Tom Petri and Tom Tauke, have done a tremendous amount of work on the Earned Income Tax Credit and a refundable child care credit. They are the experts on our "side of the aisle" on these two issues. Their work has really laid the groundwork for the consideration of these issues, and for what I hope is a bipartisan effort to enact changes in these two programs, to make them more equitable and of greater assistance to low income families.

I recognize that there are still some differences in the details among the various approaches, particularly with regard to the child care tax credit. Those differences primarily involve who will benefit and by how much. Rather than repeat arguments made on those issues, let me speak more generally to the policy guidelines which I believe we ought to follow in increasing assistance to low income families--and which led me to cosponsor this bill:

(1) We ought to encourage choice and flexibility for families. Parents, rather than state governments, should be given the resources to choose the child care arrangement best suited for their situation.

(2) To the extent possible, additional government resources ought to be distributed through making changes and building on existing programs, rather than initiating new federal programs which take years to put in place and "work the bugs out." Again, I commend the Chairman for adopting an approach which builds on existing programs and delivery systems. Beginning a new government program is always an attractive temptation for

us--even when we know that there are few resources to pay for them and most of those that can be allocated simply go to setting up the administrative mechanism, and little will be available in the way of new services.

(3) We ought to use the private sector, rather than working at cross purposes with it. We all acknowledge the benefits of work, as compared to public assistance. We need to encourage and assist those low income families who are attempting to maintain their income level, and improve it, by working. The tax credit approach, again, encourages and assists those families, without government mandates, which end up costing the employer and thereby discouraging employment, or "cookie cutter" approaches to government programs, which interfere with the family's flexibility.

One of the chief challenges of our economic system is maintaining a balance between economic growth and economic justice. We have tended to shift rather dramatically from one emphasis to the other--from pursuing equitable distribution of resources to such an extent that it interferes with incentives necessary to produce economic growth, to following policies which encourage growth but ignore those left behind. I supported the reduction in marginal tax rates during this decade as a incentive towards growth. I believe that it is appropriate to now use the tax system to provide additional resources to families which have been left behind by the sustained growth of the past 8 years.

Acting Chairman DOWNEY. Thank you, Congressman Henry, and I thank you not only for the cosponsorship, but your fine testimony. In the process of designing the bill, we very much had the principles you outlined in your testimony in mind, that of simplicity, spending without complicating the existing program and providing the widest possible latitude for people who would benefit from the program to make their own choices.

So you have correctly identified the principles that we followed.

Mr. HENRY. And if any time I can help you or a member of the committee working on this, I'll be pleased to be of help.

Acting Chairman DOWNEY. We would certainly call on you to do that. And, again, I thank you for your testimony.

Clay.

[Negative response from Mr. Shaw.]

Acting Chairman DOWNEY. Don.

[Negative response from Mr. Sundquist.]

Acting Chairman DOWNEY. Bill.

Mr. COYNE. I don't have any questions.

Mr. HENRY. Thank you, Mr. Chairman.

Acting Chairman DOWNEY. Thank you. Tom.

STATEMENT OF HON. THOMAS J. TAUKE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. TAUKE. Thank you, Mr. Chairman. It's great to be here before this distinguished group and have an opportunity to talk to your briefly about this critical issue.

I have a written statement, which I am submitting for the record.

Acting Chairman DOWNEY. No objection and it will be entered in its entirety.

Mr. TAUKE. I won't bore you with that. Let me just make some general comments.

First, as you know, I've approached this issue primarily from the standpoint of child care, not the general issue of dealing with the problems of the working poor.

But I think the principles are the same and I want to commend you for embracing those principles in the legislation that you have adopted.

It seems to me that it is very important as we develop policy in this area that we empower individuals, that we empower families, that we not give power to the bureaucracy of the Government.

I don't think we should be treating the working poor as victims who have no ability to make any choices for themselves, who have no personal dignity.

Instead, we should be treating these individuals and families as people who need opportunities so that they can solve their own problems and I think that's what you do with your proposal, Mr. Chairman.

You are empowering individuals and families and I think that's headed in the right direction.

The second principle we need to follow is we should expand choices and options for those families, give them a chance to make

some decisions for themselves by providing them additional resources.

And, again, that's what you're doing, so it seems to me in that regard your legislation heads in the right direction.

There are some great advantages, of course, of tax credits, the approach you're taking and the approach others have taken, over new spending programs. The tax credit approach maximizes choices for individuals and it reaches more people.

In the child care area, for example, we've been looking at a whole range of proposals. One is the ABC bill, on which we had testimony on last week. At best, under the ABC bill, by spending $2.5 billion, those who testify tell us they can reach 5 to 7 percent of the eligible population. And we know we're going to have to tax some working mother who maybe makes $13,500 a year in order to provide help to somebody else.

We've just reached too small a portion of the population with some of those proposals. You reach more people with a tax credit approach.

You also allow the market to respond naturally, and we have seen a lot of evidence in our subcommittee that allowing the child care market and other related markets to expand naturally is critically important. And, of course, we give an incentive to work.

We make employment pay and that is a long range very important policy.

There is one thing that is subtle too from a budgetary standpoint, which would only be understood inside the Beltway. That is we can do more, frankly, with tax credits.

If you talk to John Sununu and others, shifting the tax burden doesn't walk like a duck or quack like a duck, and so you're able to put some money into these things in a way that you could not if you were spending resources and having to raise taxes in order to accommodate new spending.

I will say I have one major problem with the legislation you propose and that's with the dependent care tax credit. All these fine things I've said about the earned income tax credit and other refundable tax credit proposals I don't think apply to the dependent care tax credit.

First of all, it's regressive. The lowest of the income families in the country, receive 3 percent of the benefits. The money is just going to the wrong families.

The low income families simply do not spend as much on child care. So even if you attempt to correct the problem by making it refundable, it doesn't do much for low income families because they don't have the resources to spend on child care in the first place. So they simply don't spend enough to take significant advantage of that credit.

The dependent care credit, it seems to me, has become symbolic for upper income families, and there's a lot of support out there in the suburbs of America. But it embraces poor public policy at a time when we have limited resources.

So I think we should not proceed with the dependent care tax credit. We ought to get rid of it and use the resources elsewhere.

There are also some problems with implementing an expanded EITC. I'm sure you've looked at those problems. Let me just mention a couple.

One is the problem of advance payment. We, of course, want to make sure that people have the ability to take advantage of this advanced payment which is currently in place for the EITC, but it is not widely used. Frankly, we just need to get more employers to implement it. I don't know exactly how we do that, but it's an issue we need to address.

I think we also have to look at the phase out of rates. I'm not sure exactly when it becomes a problem, but we do know at some point if we don't handle that rate structure correctly we're going to create some negative incentives for earnings and we don't want to do that.

So I guess I'd say to you you're headed in the right direction. I frankly would like to see a little change in the legislation relating to the EITC. I think it's a little too high in your initial proposal.

I'd like to increase it to 17 or 18 percent for one child families, 22 or 23 percent maybe for two or more children. I think we need to move a little more slowly.

In part that is because I think we need to study the effects on wages, distribution among income levels, and so on.

And, finally, I think in the legislation you ought to drop the dependent care tax credit provisions for the reasons I mentioned earlier.

In summary, I think your bill, Mr. Chairman, is headed in the right direction. I'm really enormously encouraged by our prospects this year for doing something correct in this whole area and I hope to work with you and the other members of this subcommittee in developing this legislation throughout the year.

[The statement of Mr. Tauke follows:]

The Honorable Thomas J. Tauke

Statement before the

Subcommittee on Human Resources

Thank you, Mr. Chairman, for the invitation to testify today about Federal policies to assist the working poor. As the Ranking Republican on the Education and Labor Subcommittee on Human Resources, I appreciate the opportunity to share my views with the Members of this Human Resources Subcommittee.

I applaud your initiative, Mr. Chairman, to expand the Earned Income Tax Credit (EITC) as a means of addressing the problems of the working poor. I might note that I was pleased to join Congressman Petri in the introduction of a bill providing for a similar expansion of the EITC last week. I commend that bill, H.R. 1104, to your attention as you continue to develop legislative solutions to the problems of the working poor.

Addressing the problems of the working poor, especially working poor families, is an important and timely issue. Over the last two years, I have been exploring one aspect of this problem in particular--the child care choices of the working poor. Because of the disproportionate number of children living in poverty, I believe it is appropriate to focus much of our attention specifically on the needs of low-income families with children as we develop public policy strategies to assist the working poor.

In considering an appropriate federal response to the child care issue, in particular, I have developed two broad principles on which I evaluate legislative solutions. Although I have focused specifically on the child care needs of low-income families, I believe that these principles can be applied more generally to broader issues involving the working poor.

First, it is not necessary to treat these families as victims, for whom the government must step in and takeover decision-making responsibilities. Generally, what working poor families lack is simply sufficient resources to gain access to existing markets to meet their needs. They do not lack the ability to make appropriate decisions for themselves.

It follows, therefore, that public policy should empower the individual and not the government. We should strive to help families help themselves, rather than empowering a government bureaucracy to try to solve problems for low-income families.

Second, any action taken to help the working poor should expand choices, rather than limit options for these families. Thus, rather than the government deciding what is best for low-income families and investing resources on that basis, it is highly preferable to provide those resources directly to the working poor and allow them to choose from the greatest number of options on how best to meet their own needs.

In my view, these goals are best achieved by providing greater tax benefits to the working poor rather than by creating new or adding to existing federal spending programs. The provisions of your bill, Mr. Chairman, to expand the EITC are right on target.

There are several advantages to the tax credit approach over new spending as a strategy to help the working poor. First, a tax credit expands the choices and options available to these families, rather than the government making those choices and thus limiting the options for families.

For instance, nearly all legislation that creates new spending programs to address the child care needs of working families discriminates against the choice to have one parent stay home. The only choice these bills recognize and thus subsidize is the use of government-approved (i.e. regulated) child care providers. Thus, choices to have family members care for children, or to have informal arrangements with neighbors, or to place children in religious child care settings are eliminated under most spending approaches. On the other hand, if we provide those same resources directly to the parents, all of these choices remain available.

The second advantage to offering tax credits rather than new spending programs is that with tax credits we are able to reach many more families. Permit me another example from the child care debate from last year. Under legislation authorizing the expenditure of $2.5 billion, it was estimated that only about 5 to 7 percent of the eligible population would be served. Surely, we can do better.

Third, by adding to the resources of individuals, rather than the government intervening in the market, we allow the market to respond naturally. Again, in the area of child care, some proposals call for significant government intervention into the child care market. Yet most economists agree that the child care market is functioning quite well. Our goal should be to add to the resources of individuals so that they can access the existing market, not try to artificially expand child care slots. Such intervention in the market will undoubtedly have substantial ramifications on the cost of child care, making matters worse, not better, for the working poor.

Finally, by expanding the EITC, we provide an incentive to work, rather than to rely on public assistance. A government strategy to make work pay is clearly preferable than to simply provide more and more handouts. It is surely a disincentive to work to know that one's family is better off receiving public assistance than working. We should reverse that situation.

The advantages of an expansion of the EITC, or other tax credit based on the presence of children in a family, do not apply, however, to the Dependent Care Tax Credit, which is also expanded under H.R. 882. First, we are all aware of the regressive nature of the Dependent Care Tax Credit. The Urban Institute estimates, for example, that the lowest one-third of families by income receive only 3 percent of the benefits of the DCTC.

Simply making the DCTC refundable helps in the equitable distribution of benefits under this tax credit, but not dramatically. The fact is, lower-income families do not pay as much for child care as higher income families, and many do not pay anything at all.

According to an analysis of data from the 1984-85 Survey of Income and Program Participation (SIPP) by the Congressional Research Service, among families with preschool-age children with less than poverty level income who spent money on child care, median child care expenditures were $25 per week. Among

similar families with incomes between one and two-times the poverty level, median weekly expenditures were $35, compared to $40 per week for families with incomes between three and four-times the poverty level. Median weekly expenditures of families below poverty are roughly half of those expenditures of famliies with four-times or more of poverty income, whose median weekly child care expenditures were $50. (See CRS Report 88-762, "Child Day Care: Patterns of Use Among Families With Preschool Children," for more information.)

Therefore, even allowing for a cap on expenditures which qualify for a credit, applying a greater percentage for lower-income families, and making the credit refundable, the DCTC remains inequitable, because low-income families simply do not have as much disposable income to spend on child care as do higher income families.

Moreover, the DCTC discriminates against families that make any child care choice other than paying for substitute care for their children. The result is that you have families who make the choice to have one parent remain out of the workforce (and thus sacrifice potential earnings and access to the DCTC) subsidizing two-earner couples with significantly greater earnings and a 20 percent tax credit for their child care expenditures from the government.

When three out of four preschool age children today are cared for by a parent or another family member, it seems unjustified to me to establish public policy based on the needs of one in four preschool age children, who are primarily from higher income families. It makes even less sense when we have limited federal resources to have a policy that is so poorly targetted as the Dependent Care Tax Credit, and which is at best a symbolic gesture to upper-income working families.

Let me reiterate my support for an expansion of the Earned Income Tax Credit. However, as we consider legislation such as H.R. 882 and H.R. 1104, we need to be aware of certain problems in implementing such EITC expansions.

First, we need to ensure better utilization of the EITC among those who are eligible. Enabling the working poor to be aware of and take advantage of the tax benefits available to them may be difficult. Second, we need to provide for greater advanced payment of the tax credit. While the advanced payment mechanism is in place for the EITC, it is not widely used. Third, we need to be cautious in developing the phase-out rate at which families become ineligible for the credit. At what point, for example, does the phase-out rate become a disincentive to greater earnings. Finally, we must be aware of the budget impact any such expansion of the EITC will have and be creative in developing ways to absorb such an expenditure in the overall budget.

I am anxious to work with you, Mr. Chairman, and the Members of this Subcommittee to resolve these and other issues. Initially, I recommend that we consider moving somewhat more slowly in expanding the EITC. For example, increase the EITC to

17 or 18 percent for one child and 22 or 23 percent for two or more children at first, rather than the immediate jump to 21 percent and 30 percent respectively. I believe that we should also consider a more generous tax credit for families with young children, to offset the greater costs of caring for preschool age children, than to school-age children.

Further, I recommend that we provide for an extensive study of the effects of such an EITC expansion. For instance, who is able to access the credit, is the distribution of the credit among income levels equitable, is the advanced payment mechanism being utilized, etc.? In addition, we should study the potential that the availability of the EITC depresses wages employers are willing to pay.

Finally, I suggest that you drop the provisions relating to the Dependent Care Tax Credit from H.R. 882, for the reasons outlined above. If anything, the DCTC should be limited, rather than expanded.

Thank you again for this opportunity to share my views with the Subcommittee. I look forward to working with you to develop strategies to help the working poor that are equitable and that will empower individuals to help themselves rather than relying on the traditional public policy that empowers government to try to solve individual problems facing the working poor.

Acting Chairman DOWNEY. Thank you, Tom. Let me just say that we welcome your opinion. You've appeared before this subcommittee in the past and we've really benefited from your views. I have personally.

Let me go over some of the things that you find objectionable with the legislation I've introduced, and if you can, expand on them some.

We were concerned as well when we did the dependent care credit proposal that there might be a better way to get that money into the hands of individuals basically by expanding the earned income tax credit even further.

But we took notice of the fact that President Bush was the one who had suggested a refundable dependent care credit. So are you making the same statements to Mr. Sununu and to him that you are making to me?

Mr. TAUKE. Brilliant as President Bush is, he has been known to make a few mistakes. I know that the President has talked about keeping the dependent care tax credit, and I know politically there is quite a bit of support for that.

As you know, the dynamics of things around here is that it's tough to do anything that takes something away from the middle class or the upper middle class.

Those of us who are among the yuppies of the nation, we know how to work the system. But the bottom line is that giving those resources to people like me, my family, it's nice. We enjoy it; it's a nice token statement on the part of the Government that they appreciate the efforts we're making in providing decent care for our children, but it sure is not necessary public policy.

And when we're at a time when you've got to make choices, it's pretty tough, I think, to say that the family with an income of $50,000 a year is going to get money while we hold back on the one with $18,000 a year. I just think the money can be better directed toward the lower and lower middle income families.

Acting Chairman DOWNEY. In our making it refundable——

Mr. TAUKE. Yes, you can take a step in the right direction——

Acting Chairman DOWNEY. We focus a great deal of that money on the very people you want us to spend it on and when we do the analysis of whether or not they would spend it, we're fairly comfortable in the belief that there are people who have child care expenses who are earning low incomes who will actually use this money in the way that we would like them to use it.

So I'm not sure that I agree with you. You mentioned 2 or 3 percent of the amount of money that is used in all child care would get focused on this group.

Mr. TAUKE. Well, that's now. That's under current law. Obviously when you make it refundable, it improves. My judgment is that when you look at a family with 10 or 12 or 15 thousand dollars a year income, they can't put $2,000 into child care for their children.

So, therefore, they have less ability to take advantage of the full tax credit even if it is refundable. So unless it is restructured in some way, the bottom line is they don't have the money to spend in the first place, so even a refundable tax credit doesn't help them that much. But that's an observation.

Acting Chairman DOWNEY. And it is a valid point and we'll look at it because we were faced with some choices when we drew this up as to whether or not we wanted to do just a very big EITC or a combination of EITC and dependent care credit.

As far as the question of reducing it for upper income people, I tried that in the last Congress. That did not work and while I might be happy to go back up that mountain again with you, I suspect it is a very steep climb.

Mr. TAUKE. It is. It is a steep climb. I suspect a 33-percent tax bracket isn't going to be an easy one either.

Acting Chairman DOWNEY. No.

Mr. TAUKE. There aren't any easy ways to come up with the resources, but it's just something we ought to discuss as we go down the road.

Acting Chairman DOWNEY. Can I ask you about the financing mechanism we use? I mean you're a good solid Republican looking for a higher office. How do you view the fact that we take the 28 percent rate and take it up to 33 and basically use that money to help the people that you have worked so long and hard and courageously to help?

Mr. TAUKE. Did somebody in the other side of the Capitol ask you to ask that question?

Acting Chairman DOWNEY. No.

Mr. SHAW. I would suggest the gentleman ask the Chairman of this full Committee.

Mr. TAUKE. I'm not sure we want to start in on the tax bracket question and what the upper level rates should be in part, because I'm not sure we want to open that can of worms. As you may know, and may be why you asked, I've said publicly before that I think there is some problems with the way the current Tax Code is structured where you have the dip in rates for the higher income folks. Those in our category end up at a higher level than those who earn twice as much money.

So I think there is something to be looked at there. I'm not sure that we can, however, tackle that issue in the current political atmosphere. It is just the general feeling among Members of Congress that we ought to keep our hands off the Tax Code for a while.

So I guess I'm not willing to embrace that notion at this juncture.

Acting Chairman DOWNEY. A good diplomatic and political answer. In any event, we welcome your input and hope to work with you as this legislation goes forward.

Clay.

Mr. SHAW. Mr. Chairman, I don't have any questions, but I do want to compliment the last three speakers as I did Mr. Miller. They have presented good and innovative ideas. As a Republican Member of the Congress, I am proud to be associated with their remarks, and I think they show that on our side of the aisle that we are looking for solutions to the problem of the working poor.

I would also like to invite the chairman, Mr. Downey, to work with us in creating bipartisan legislation. As a conservative, I feel strongly that the funds that are available should be distributed primarily among those who work.

And I think that if we are looking at child care, we've got to look at the entire plate and see how these tax resources are being used. We may be able to use some of the funds we now have more wisely before we start looking at new sources of revenue.

So, perhaps I'm a little naive having been unscarred by this particular issue, but I'll be glad to share war stories with you and then venture with you to modify the dependent care tax credit and use the savings to help the working poor.

Mr. TAUKE. Please let me know, Mr. Shaw. We had an awful lot of people on our side of the aisle who signed on to our package last year which included some pretty strict limits on the income levels and did eliminate the dependent care tax credit.

Mr. SHAW. I believe, Mr. Chairman, that a lot of those people found out what was really in the bill after they had already become cosponsors.

Mr. TAUKE. You aren't accusing us of false advertising.

Acting Chairman DOWNEY. Mr. Sundquist.

[Negative response from Mr. Sundquist.]

Acting Chairman DOWNEY. Tom, thanks very much for coming and we look forward to working with you and getting something done this year.

Mr. TAUKE. Thank you.

Acting Chairman DOWNEY. The committee will next hear from a distinguished panel of policymakers, David Ellwood, professor of public policy at Harvard University and the John F. Kennedy School of Government, from the American Enterprise Institute, Dr. Marvin H. Kosters, director of economic policy studies, and from the Center on Budget and Policy Priorities, Robert Greenstein.

Professor Ellwood, I reread part of "Poor Support" last night, and we again take notice of the very fine work you have done. Many of your ideas, if we can pay you this ultimate compliment, and those of Mr. Greenstein and Mr. Kosters, have found their way into the legislation we have introduced.

We are honored by your presence, and look forward to your testimony.

STATEMENT OF DAVID T. ELLWOOD, PROFESSOR OF PUBLIC POLICY, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY

Mr. ELLWOOD. Thank you very much. You are very kind.

I have really found this a very exciting hearing. I am even cautiously optimistic about the whole issue, which is a rare event.

I really do appreciate the invitation to talk about the working poor, because it is a group that seemingly has been invisible, for reasons that I can't quite fathom.

My message is really straightforward; that we must adopt a very simple proposition, and that is the proposition that is contained, in fact, in the subheading of your bill, that families that work shouldn't be poor.

Congressman Petri suggested that that seems like an awfully ambitious goal. Gee, it seems to me that that ought to be the number one goal in America. That is what the American dream is

all about. It is about, if you work in America, you can make it in America. We forgot families that are working and are still poor.

The bottom line, my bottom line on that score is this: If we do not adopt the simple message that if you work you should not be poor, we will never do very much about children's poverty in America. We will not help two-parent families, we will not help single-parent families very much; unless we adopt that simple principle, we are never going to get very far.

It is that simple, and it is that important.

I mentioned that the American dream holds that everyone who is willing to work should be able to make it in America. We certainly heard a lot about it in the Presidential campaign this fall. Both candidates embraced this novel idea.

For many, of course, the dream really has been fulfilled. We hear, and have seen paraded many Americans that have done it. But it simply is not true, as you know, that if you work you are not poor.

There are over 5 million Americans in families where someone is working full-time, all year, and the family is still poor. For them, it seems to me that the American dream may seem much more like a nightmare.

I, again, do not understand why this group has been ignored. I suppose that the conservatives thought that the group did not exist, and that liberals were preoccupied with others; but the reality is, they do exist.

The media—and to some degree, lawmakers—seem to be very much concerned with the underclass, the ghetto residents, and so forth, when in fact you look and you see only about 7 to 10 percent of the poor are living in what might be classified as a big city ghetto.

Given that, it turns out that there are more than twice that number that are living in families where somebody is working all the time. So, this is a much bigger problem than the so-called underclass that seems to preoccupy all of our attention.

Who are they? Here is something where even today's testimony may be a little misleading. These are mostly two-parent families. They are not families on welfare; they are families that are mostly two-parent.

They typically have two or three children. They are very disproportionately white. They defy all the traditional stereotypes. They are by and large high school graduates.

They are the so-called bedrock of America. They are working, they are playing by the rules; and yet they are still poor.

If those families cannot make it in America, what about the families that really do have a lot more disadvantages? What can we realistically expect for them?

Others have pointed out that these figures should not be so unbelievable to us, when we think about how much the minimum wage pays. A one-and-a-half minimum wage job does not take a family of four out of poverty.

It is just not true that work always pays: It does not. Frankly, for these families, the biggest part of the problem comes down to the thing that you are trying to address. It is wages, wages pure and simple.

Working poor families ride the same roller coaster that middle America does, but they have the front-row seat. One can predict rises and falls in the poverty rates of children in two-parent families almost perfectly, by looking at what is happening to wages or the earnings of full-year, full-time workers, the median earnings of full-year, full-time workers.

That is, we can tell what is going to happen to working poor families by following what is happening to the middle class. This is not a group that is outside the mainstream; they follow the mainstream. The problem is that, when the rest of America stumbles, this group falls.

When real wages for the middle class move up, those at the bottom move up. But when real wages fail to keep pace, then more Americans join the ranks of the working poor.

Now, it also turns out to be the case that changes in wages are vastly more important than changes in unemployment, in helping these families.

The reason for that is simple. When the unemployment rate goes down, when wages fail to rise—which has happened to a large degree with the last recovery—what we do is to move a whole bunch of people from the unemployed poor into the working poor. They still are getting low wages, so they have managed to find jobs now but they still are in a position where they are poor and still working.

So, what are we going to do? One thing is that we could look for economic growth. The so-called trickle down really works for these families. When the economy is strong, and wages are growing, and unemployment is falling, these families do better. But as you know, Mr. Chairman, there really has not been much in the way of trickling down in the past 15 years.

Wages of the median full-time worker are below where they were any time during the 1970s. So this group has really been getting hurt.

Worse still, there is increasing evidence that things are getting worse for those near the bottom. A lot of different figures have been thrown about, but my outlook says that about 9 percent of full-year full-time workers in 1979, male workers, had annual earnings too low to support a family of four. That was 9 percent in 1979. By 1987, it was up to 13 percent.

Young families seem to be particularly hard-hit. Poverty rates for two-parent families where the husband was under 25 jumped from 10.5 percent in 1979 to 21.5 percent in 1986, as compared to a much, much smaller rise for other families.

Of course, it is not just two-parent families that are affected, as has been pointed out. It really is true that, right now, if you work and you were on welfare, you are not going to make very much progress. Unless you can find a job that pays, say, 50 or 75 percent above the minimum wage, unless it has medical benefits, unless you can find inexpensive day care, you are just not going to be better off working than on welfare.

The notion that a woman with a poor education and young children will move right into a job that pays $5, $6, $7 an hour, and that she can work all the time—the notion that she can do that, it seems to me, is just absurd.

It would seem to me that welfare reform all by itself, while a very important beginning, all by itself it mostly would seem to convert the welfare poor into the working poor. That is really not what we must aspire to.

Finally, what do we do now? What do we do now for these families, these working poor families? The answer is, as you know, virtually nothing.

A two-parent family with a full-time worker usually does not qualify for welfare, they usually do not qualify for Medicaid. They are eligible for food stamps, but very few of them collect them.

Indeed, I think the most troubling finding I have made in all of my work on poverty over the years is this: That the poorest of the poor are two-parent families with a full-year full-time worker.

When you add in government transfers, families with two parents and a full-year full-time worker are further from the poverty line than single-parent families on welfare, and two-parent families where someone is disabled, and two-parent families where someone is unemployed. Because we have done nothing.

Part of the reason it does cost money to work on these problems is that we have ignored the working poor, very much at our peril.

I regard this situation as really a very serious challenge to some of our most precious values. If people who play by the rules still lose the game, what is the point of joining in the mainstream? What signals are we sending those who try to hold a family together in spite of economic hardship, to those who choose work over welfare, to those who are willing to work for the American dream?

The tragedy is that it is not terribly hard to figure out ways to help these families. A strong and growing economy would help, but everyone favors renewed productivity growth and low unemployment. We get it predicted every year in the budget estimates coming from whoever is in the White House.

But it has not materialized. And we need not, and must not, abandon these families while we wait for the Godot of economic growth. The answer is not in expanding welfare, either. They do not want welfare, and I do not think that is the right strategy.

Instead, we ought to adopt measures that make work pay, and that ensure that all families get medical protection. The Employment Incentives Act that you introduced is a very important step towards promoting and preserving the American dream.

As others have pointed out, the EITC is really a marvelous way of helping low-income families. What it does is, give tax credits for each dollar that someone earns. In effect, it is a pay raise for the working poor. Only those who work, benefit.

By adjusting the EITC by family size, we help protect families with more children who have greater economic need. There is little danger that this can reduce employment among those at the bottom; indeed, it is likely to increase it.

It is my impression that nearly all academics who care about the poor, regardless of their ideological orientation, seem to believe that a higher EITC is an excellent policy. Indeed, I participated in a recent event sponsored by the Forum on the Future of Children and their Families, of the National Academy of Sciences. A variety of people were invited there, from various disciplines, including a variety of congressional staff as well.

The EITC seemed to be almost unanimously seen as a valuable investment in America's children and its values and its dreams.

I also endorse the idea of making the day care tax credit refundable. Assuming we continue to maintain the day care tax credit, I see no possible legitimacy for saying we are going to deny it only to those at the bottom. Indeed, as you pointed out, the notion of the day care credit is, you do not get the day care tax credit if you do not spend the money. So it is not as though adding this provision for the low-income families—the money that is going to be spent will go to families that have real day care expenses in trying to work. Now, whether or not you want to tax it up at the higher end, I agree is a very different question.

I do want to make one thing clear, though; that the expanded EITC and the day care tax credit, those measures alone are very exciting and important first steps, but they are not going to do it all.

They alone will not guarantee that anyone that works in America is not poor. A minimum wage job will still not push a family of four out of poverty, even with this dramatically expanded EITC. The arithmetic just does not work out.

In my view, the only way to really ensure that work pays is to adopt a higher EITC and raise the minimum wage back to the inflation-adjusted level it stood at throughout the 1960s and 1970s. After all, adjusting for price changes, the minimum wage is now where it was in 1956.

Yes, raising the minimum wage will have some modest employment effects; but the evidence shows that, on net, the poor will be better off. The minimum wage is controversial, but frankly the tragedy of families, mostly two-parent families, who work and are still poor ought to be even more controversial.

If we adopted this bill and raised the minimum wage to its previous level, then we really would ensure that every American family where someone works need not be poor.

One final point. We also really have got to do something about the lack of medical protection for working poor families. Indeed, that is one of the main areas that they talk about, when you actually go out and meet with them.

They often go without essential preventative services, since they cannot afford to pay for them. Any illness that pushes one person into the hospital for even a few days can rob a family of everything they have worked for, everything they have sought to build, and leave them with a debt they will never repay.

Every industrialized country except South Africa has found a way to ensure medical protection. It does not have to be in the form of national health insurance. Plans based on employer-mandated or government as an insurer of last resort would make sense. Medicaid buy-ins could help. Regardless of the details, surely we can protect those who work from the financial burdens of health care.

Let me just conclude by reiterating my opening statement. Unless we adopt the notion that families that work should not be poor, we will never make more than a tiny dent in the poverty problem. We will never move very many people off welfare into work.

We will leave millions of two-parent families poor in America. And we will be, very clearly, spitting in the face of people that are working hard, playing by the rules, but losing the game.

So, I strongly urge you to adopt this simple proposition: People who work should not be poor. Thank you very much.

[The statement of Mr. Ellwood follows:]

Testimony of David T. Ellwood[1]
before
Subcommittee on Human Resources
Committee on Ways and Means
U.S. House of Representatives

Mr. Chairman and members of the Committee, I appreciate your kind invitation to offer testimony on the tragedy of poverty among working families, a group which has become "invisible poor". Much of my testimony will be drawn directly from my recently published book, Poor Support: Poverty in the American Family (Basic Books).

My message is straightforward. We must adopt the simple proposition which is included in the title of the bill before you: families that work shouldn't be poor. If we do not, we will never be able to do very much to help poor children. Its that simple and that important.

The American dream holds that anyone who is willing to work can make it in America. It was deeply embraced by both presidential candidates this past fall. And for many the promise of America has been fulfilled. But it simply is not true that if you work, you will not be poor. There are over 5 million Americans living in families where someone is working full-time all year and yet the family remains poor. For them the American dream may seem more like a nightmare.

I cannot understand why this group has been ignored for so long. I suppose conservatives thought they didn't exist and liberals were preoccupied with others. Perhaps the media and lawmakers have become so concerned with the so called "ghetto underclass" that most Americans believe that the typical poor person in America is found lives in a big city slum. Well it is just not so. Study after study has shown that big city ghetto poverty represents only 7 to 10 percent of the poverty in America. There are twice as many poor persons living in families where someone already works all the time. And many, many more live in families where someone worked part of the time, but at a wage so low that even full-time work would have left the family poor.

Who are the working poor? They are primarily two parent families. They are mostly white, typically with two or three children. Roughly half live in small towns and rural areas, half in the cities and suburbs. The majority are high school graduates. In short, they do not fit the stereotypes at all. And if these families are having trouble making it in America, think what families with greater disadvantages face.

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[1]David T. Ellwood is Professor of Public Policy at Harvard's John F. Kennedy School of Government.

Some may find these figures unbelievable. But they are easy to understand. Today a full time job at the minimum wage will not even support a family of two at the poverty line. One full-time and one half time minimum wage job won't push a family of four out of poverty. Work does not always pay.

For these families the biggest part of the poverty problem comes down to wages, pure and simple. Working poor families ride the same economic roller coaster that middle America does. They have the front row seat. One can predict rises and falls in the poverty rates of children in two-parent families almost perfectly by looking at changes in the earnings of median full-time male worker. When real wages (adjusted for inflation) rise for the middle class, those at the bottom move up too. When wages fail to keep pace with the cost of living, more Americans join the ranks of the working poor.

Changes in real wages are vastly more important in reducing poverty than falls in unemployment as the experiences of the past few years have shown. The reason is simple: many of the unemployed poor receive low wages when they do work. Reduced unemployment without wage growth merely converts many of unemployed poor into the working poor.

Thus economic growth which produces wage growth, so called "trickle down," really could work for these families. When the economy is strong, with wages growing rapidly and unemployment falling, then these families do better. But when the economy stumbles these families fall. Unfortunately there hasn't been much trickling down in the past 15 years. Median earnings of full-time workers remain below the level it reached in 1973. And even the recovery of the past several years has not raised wages much. When the wages of the median worker have been stagnant for 15 years, we surely cannot expect things to improve at the lower end of the economic spectrum.

Worse still, there is increasing evidence that things are getting worse for those near the bottom. In 1979, about 9 percent of year round full time male workers had annual earnings too low to keep a family of four above the poverty line. By 1987, although median earnings of full time workers had changed little, 13 percent of year round full time workers had earnings below the line for a family of four. Young families seem to have been particularly hard hit. Poverty rates for two-parent families where the husband was under 25 jumped from 10.5 percent in 1979 to 21.5 percent in 1986 as compared to a rise of from 5.8 to 7.5 percent for families with a head over 30.

And it isn't just two parent families who are affected. The whole thrust of welfare reform has been to move families from welfare to work. Yet figures in the remarkable "Green book" put out by this committee shows that unless a single parent can work full time at a job paying at least 50 to 75 percent above the minimum wage

that offers medical protection, and unless she can find very inexpensive day care, she will be no better off working than on welfare and she will still be poor. The notion that a women with a poor education and young children will move right into that sort of job is absurd. It would seem welfare reform may seek to convert the welfare poor into the working poor. Unless we can make work pay better, there is little real hope that we can make most of those on welfare self-supporting.

What support do we now offer those families who embody the work ethic by working long hours at low pay? Virtually nothing. A two-parent family with a full-time worker usually will not qualify for any welfare of Medicaid. They are eligible for food stamps, but few choose to collect them. Indeed I think the most troubling finding I have made in all of my work on poverty is this: After transfers, two-parent families with a full-year full-time worker are the poorest of the poor. Their income is on average further from the poverty line than poor families with an unemployed worker or families with a disabled worker. They are further from the poverty line than single parent families where no one works and the family collects welfare. Its not that welfare pays so well, as this committee well knows. The problem is that work sometimes pays so little.

I regard this situation as a challenge to some of our most precious values. If people who play by the rules still lose the game, what is the point of joining in the mainstream? What signals are we sending those who try to hold a family together in spite of economic hardship, to those who chose work over welfare, to those who are willing to work for the American dream?

The tragedy is that it isn't terribly hard to figure out ways to help these families. Of course a strong and growing economy would help enormously. Everyone favors renewed productivity growth and low unemployment. But we need not and must not abandon these families while we await the Godot of economic growth. The answer does not lay in expanding public assistance. These families don't want welfare. Instead we ought to adopt measures which make work pay and that insure that all families get medical protection. The Employment Incentives Act represents a very important step towards preserving and promoting the American dream.

An Expanded Earned Income Tax Credit (EITC) is a marvelous way reinforce the efforts of low income working families. For those earning low wages, it adds tax credits for each dollar earned. In effect it offers a pay raise for the working poor. Only those who work benefit. And by the adjusting the EITC by family size, we can help protect families with more children who have greater economic need. There is little danger that it will reduce employment among those at the bottom. Indeed it may well increase it.

It is my impression that nearly all academics who care about the poor, regardless of their ideological orientation, seem to believe a higher EITC would be an excellent policy. Indeed, I participated in a recent event sponsored by Forum on the Future of Children and their Families of the National Academy of Sciences, there was nearly unanimous support for the idea. The EITC is an enormously valuable investment in America's children, its values, and its dream.

I also endorse the idea of making the Day Care Tax Credit refundable. The current credit unfairly goes only to middle class families. Those working poor families who need help the most often get little.

Let me make clear, however, that these measures alone will not guarantee that families who work will not be poor. A minimum wage job still will not push a family of four out of poverty even with an expanded EITC. The arithmetic just does not work out. In my view, the only way to really insure that work pays is to adopt a higher EITC and raise the minimum wage back to the inflation adjusted level it stood at throughout the 60s and 70s. After adjusting for price changes, the minimum wage is now where it was in 1956. Yes, raising the minimum wage will have some modest employment effects, but the evidence clearly shows that on net they will be better off. The minimum wage is controversial. But the tragedy of families who work still being poor seems even more compelling. If we adopted this bill, and raised the minimum wage to its previous level, then we really could ensure that families that work will not be poor.

We also must do something about the lack of medical protection for working poor families. They often go without essential preventive services since they cannot afford to pay for them. If an illness pushes one person into the hospital for even a few days, they may lose everything they have sought to build, and be left with a debt they can never hope to repay. Every industrialized country except South Africa has found a way to insure medical protection. It need not be in the form of national health insurance. Plans based on employer mandated or government as insurer of last resort might be adopted. Medicaid buy-ins might help. But regardless of the details, surely we can protect those who work from the financial burdens of health care.

The plight of poor families with full-time workers is a direct challenge to those who want to preserve the ideal that anyone who is willing to work can make it in America. I congratulate the sponsors of this bill for taking seriously that challenge. People who work shouldn't be poor.

Acting Chairman DOWNEY. Dr. Kosters.

STATEMENT OF MARVIN H. KOSTERS, DIRECTOR, ECONOMIC POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

Mr. KOSTERS. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before this subcommittee. What I would like to do if I may is to summarize rather briefly the statement that I have already submitted.

Acting Chairman DOWNEY. Your statement—all your statements—will be put in the record in their entirety.

Mr. KOSTERS. Thank you.

The main general point that I really want to make in my testimony is the following: I want to emphasize that how poor people have fared, including the working poor, has been mainly a matter of how the average worker has fared. That is to say, if incomes of workers on average have gone up, then the number of poor tends to decline and their well-being tends to increase.

This is very similar to what Mr. Ellwood has already said. Another way of saying that of course, is that there has not been very much of a change in the shape of the income distribution as a whole, particularly near the bottom. We can look back through the period of the fifties and sixties. This was a time when real wages were increasing fairly strongly. It was also a time when the poverty rate was declining steadily. If you look at more recent years, since the late 1960's or early 1970's, you find rather little change in real hourly earnings, and you also find relatively little change in the poverty rates. In fact, you find that in the 1980's poverty rates are somewhat higher than they were earlier in the 1970s.

So when you look at these broad trends, you need to recognize that it could have been the case that an unusual number of workers fell down lower in the income distribution. This could in principle be the case. In practice, that is not the case.

I would like to expand on this distinction by discussing, first of all, what has happened to average pay, and then what has happened to the shape of the distribution.

First of all, most of our measures of income from census data and other sources include only money wages. What has happened in the past 15 years is that, although compensation per hour—total pay per hour of work—has gone up somewhat more slowly than in the 20 years before 1973, it still gone up somewhat. What has happened is that a greater share of a worker's overall pay—the average person's overall pay—has been devoted to things like health care, pensions, and Social Security taxes.

This has meant that a person's cash pay has gone up by less than total pay. Indeed, most of the increase in productivity that has occurred in the economy as a whole since about 1973 has been spent on increases in nonwage benefits, leaving very little for increases in cash wages. And that, of course, makes most of the income data we look at increase very little. In fact, there are some groups of course, whose relative wages have declined, who fared less well.

Now, a second question—in addition to what happened to the average—is whether there has been some sort of disproportionate in-

crease in the share that are paid low wages? There has been a good deal of discussion about that. Some have made reference to that proposition again this morning. But I believe that this kind of change has not occurred.

I do not believe that the evidence as a whole supports the view that the share of workers at the low end of the distribution has increased. There is one important exception, and that is that in the immediate neighborhood of the minimum wage, there has been an increase in the share that lower real wages because of the decline of the real value of the minimum wage.

However, apart from that, and well above minimum wage levels, you do not find an increase in the share of all workers with low annual earnings. You do not find an increase in the share with low hourly wage rates either over the last 6 or 8 years, or in fact over the past 20 years.

So I think it is important to recognize that what has happened to poverty, what has happened to the working poor, is not the result of a flaw in labor market performance that has brought us an extraordinarily large number of low-wage workers.

There have, of course, been a variety of changes that have occurred. There have been changes in industry mix, and these changes all by themselves would tend to lead to reduced wages. But the interesting thing is that those changes have been accompanied by, and bffset by, changes in the occupational mix that tend to work in the opposite direction. There has been an upgrading in occupational categories. I think this is fortunate in many respects in that the newer occupational mix is much more consistent with the schooling and skill levels of new entrants into the work force as compared to those who are retiring.

Now, let me make two comments about what I think this means in terms of the policies we are talking about today. First of all, it seems to me that in the labor market, adjustments in relative wages that we have seen have by and large been constructive ones. That is, these wage adjustments have provided us with the flexibility in the labor market to absorb an enormous "baby boom" generation of workers into the work force, a large number of women associated with the rise in their labor force activity, and in addition more immigrants than we had in the past. So I believe that wage adjustments have been by and large constructive.

A second comment is that the working poor and low-wage people are not an identifiable group who have simply fallen behind while the rest of the work force prospered enormously. Consequently, we do not have a situation in which there have been big gains for some, but no gains or even declines for others. As a result, changes that make an effort to transfer more income to low-income people have the characteristic that they involve more or less pure redistribution. They would not simply be equalizing uneven gains by transfers from some who have gained a great deal to others who have gained less or fallen behind. That is really another way of saying that what has happened is that the income distribution, the earnings distribution itself, has not been moving to the right because real incomes have not increased. That is the main source of the problem—not that there has been a big change in the shape of the distribution, a big increase in low-wage workers.

What that means, I think, is that except for the fact that productivity growth has been slower in the past 15 years, the problem of low-wage workers is not primarily one that comes from changes in the labor market. The status of the working poor has not declined because of an increase in the share of the work force with low wages.

When I look at members of the working poor, and at the poor generally, it seems very clear to me that there is one family category, one household type, that has fared much worse than most over the past 15 or 20 years. That is the category of single mothers with children. This is a category that has increased sharply as a share of all families with children. And this change in proportions is one of the reasons why we have so many children living in poverty.

An increase in the share of single-mother-with-children families tends to raise poverty levels because their poverty rates are five to six times the levels of poverty rates of husband-wife families. This is the category that has fared worst. They include a lot of working single mothers. But the interesting thing to me is that how these families fare is not mainly determined by the wages that they are paid. It is much more strongly associated with whether they work, and how much they work.

So there I differ somewhat from Mr. Ellwood. I think that opportunities for work and job availability are extremely important. We need to be very concerned about that in policies in this area.

Finally, let me make a couple of comments about the proposed Tax Code changes such as those in H.R. 882.

In my view, those proposals take a very big step. That is they go farther than the principle that poor people below some low income level should not pay any net Federal taxes. What they do is to subsidize people for working and subsidize child care—in particular, commercial arrangements for child care where payments are actually made.

I think that there is a danger in moving very much in this direction. The main danger is it would encourage economic inefficiency. It would encourage waste. It would lead people to do things that they would not otherwise do in the absence of this kind of tax incentive.

So I think it would be prudent to ask first what have the effects been of the current earned income tax credit. Unfortunately, we will not know very much about that for at least a couple of years, and its effects will not be reflected in the normal measures of poverty. It can only be reflected after an analysis of the effects of tax and benefits programs of the kind that the Census Bureau has just begun to do this year.

I don't believe that wage subsidies and child care subsidies in the form they are being proposed are desirable policies. I will make a couple of closely related suggestions that I think should be strongly considered.

First of all, I believe it would be desirable if the current earned income tax credit were extended to all workers, whether or not they have dependents. If they are poor, they are also part of the working poor, and it seems to me from the point of view of equity, they ought to be eligible for an earned income tax credit that ap-

plies the same principle—no net Federal taxes—that is now applied to those with dependents.

A second suggestion I would make is that there ought to be a dependent tax credit for low-income families with children rather than dependent care credit. Whether or not it should be refundable it seems to me to be largely a question of whether the payments involved should be administered through the Tax Code or through other welfare arrangements.

Now, of course, this committee spent last year dealing with welfare reform. These subjects may have come up in that connection. But I believe that it would be desirable to avoid biasing parents' choices toward child care rather than caring for children themselves, and certainly to avoid biasing their choices towards some type of commercial arrangements for child care rather than much more informal arrangements.

Thank you, Mr. Chairman.

[The statement of Mr. Kosters follows:]

Statement of Marvin H. Kosters
Director, Economic Policy Studies
American Enterprise Institute
before the
Subcommittee on Human Resources,
Committee on Ways and Means
February 28, 1989

I appreciate the invitation to testify here today on problems of the working poor. I am employed at The American Enterprise Institute for Public Policy Research, a private, nonprofit research organization, but the views expressed in my statement are my own.

In your invitation, you asked that I discuss relevant background information on factors that have affected working poor families. I welcome the opportunity to discuss labor market and demographic trends that provide the context for proposals, such as those in H.R. 882, to increase the incomes of working poor families through the tax code.

Overview

Two broad economic trends in our recent experience give rise to legitimate concerns about how well the poor have been faring and what might be done to improve their economic status. The first is that the poverty rate first stabilized and then rose after the late 1960s, following a fairly steady and very significant decline during the previous twenty years. The second is that average real wages have also been stagnant since the late 1960s or early 1970s. In broad terms, these data tell a very similar story--poverty rates fell when rising real wages raised the distribution for the work force as a whole. Historically, real wage growth--generated by rising productivity -- has been the main source of increased economic well-being for families as a whole, and for the poor as well.

Some changes in the shapes of distributions have occurred over the years, but their influence on measures of poverty has been small compared with shifts in the distribution as a whole that were generated by real wage growth. Moreover, the character and significance of changes in the shapes of distributions that have occurred have frequently been misunderstood, particularly as such changes have affected low-wage workers.

Trends in Real Pay

Although the slowdown in real income growth since the early 1970s is generally recognized, its significance for a wide range of related data has sometimes not received the attention it deserves. Slower growth in average productivity and real pay have obviously meant smaller increases in living standards for the average worker. In the absence of changes in the shape of wage and earnings distributions or other demographic changes, it also implies slower improvement for people in the lower part of the distribution.

The dimensions of the slowdown in growth of productivity and pay are illustrated by data on real average hourly compensation, including non-wage benefits. Real compensation per hour has increased at an average rate of less than 1 percent per year since 1973 compared with close to 2 1/2 percent for the preceding twenty years. The comparison looks worse for hourly wages, however, because the increase in

overall compensation that has occurred during the past fifteen years has consisted mainly of non-wage benefits.

Measures of real average hourly wages, as a consequence, show either very little change or some decline since 1973, depending on how they are adjusted for inflation. Since non-wage benefits are not included in data on incomes and poverty as these are regularly reported, Census-based measures of income show stagnation or deterioration for the average worker or family. This is in marked contrast to the twenty years before 1973 when real average hourly earnings increased by about 2 percent per year on average.

In summary, there has been some improvement in living standards since the early 1970s. But the improvement has been much slower than previously, and most of the improvement that has occurred does not show up in conventional measures of money income.

Trends In Jobs That Pay Low Wages

The influence of changes in the labor market on people at the low end of the income distribution has recently received a great deal of attention. Two related questions that deserve discussion are what the evidence actually shows and how that evidence should be interpreted. Very different answers have been put forward to these questions. I will begin with a discussion of the evidence.

There is continuing controversy about whether low-wage jobs have become increasingly prevalent, and this is not an appropriate forum for resolving the analytical issues involved. Consequently, I will present evidence from data I have analyzed, much of it with assistance by Murray Ross, without critical comparisons with data developed by others.

Annual Earnings. One way we have examined the evidence is by looking at annual earnings of all wage and salary workers. For the work force as a whole, the fraction of workers in the middle of the distribution (between half the median and one-and-a-half times the median), has remained essentially unchanged during the past twenty years. The share at the upper end increased slightly, while the proportion of workers with low annual earnings (accounting for about 30 percent of workers) has declined. These data, in other words, show a declining proportion of the work force with low annual earnings.

When the same method is applied to year-round, full-time workers, the results are different in two important ways. First, the share with low earnings (half their median or less) is much lower--about 10 percent instead of about 30 percent--even though their earnings levels are about 50 percent higher. Second, instead of gradually declining over time, the proportion of year-round, full-time workers with low annual earnings first declined from the late 1960s to the late 1970s and then rose again to approximately the same level as in the late 1960s.

The low-earnings proportion of those who worked a full year and usually worked full time has thus increased since the late 1970s. Because there is considerable variation in the number of hours a week and the number of weeks a year they work, it is important to examine hourly wages.

Hourly Wages. To examine what has happened to jobs that actually pay low hourly wages, we looked primarily at the proportion of workers earning hourly wages 25 percent below the median or less. Both for all workers and for full-time

workers, the proportion that earned low wages was essentially stable (at about 30 percent) for the past fifteen years.

The degree of equality for the wage distribution as a whole was also examined by computing measures of percentage variation (the coefficient of variation) for hourly wage rates. For the work force as a whole, these measures show declining inequality for the past fifteen years; for workers paid by the hour there has been essentially no trend.

Most studies of inequality that I have seen show a gradual increase in dispersion for annual earnings over the last forty years. In recent years, that increase has apparently been concentrated in the upper part of the distribution. For hourly wage rates, however, inequality has apparently not increased, and the fraction of workers with low hourly wages has remained unchanged.

The decline in the real level of the minimum wage since 1981 is frequently noted in discussions of poverty or low-wage jobs. This decline has made more low-wage jobs available, particularly for young, part-time workers than would otherwise have occurred. It is noteworthy that in spite of this increase in jobs associated with a lower real minimum wage, the proportion of the work force with low wages has not increased. Moreover, the decline in the real level of the minimum wage since the early 1980s has been accompanied by a decline in the poverty rate. On the basis of recent experience, the erosion of the purchasing power of the minimum wage apparently resulted in neither a deterioration in overall job quality nor an increase in poverty.

What can we conclude about whether changes in the shape of earnings and wage distributions have contributed to poverty or to problems faced by the working poor? I summarize the evidence as indicating that there has been very little change in the shape of distributions at low wage and earnings levels. In particular, there has not been a disproportionate increase in low-wage jobs. The idea that working people have been slipping into poverty because job quality has deteriorated--because a larger proportion of jobs now pay low wages--is not supported by the evidence. The cessation of further reductions in poverty since the late 1960s is attributable instead to stagnation in average real wages, not to a bulge in the proportion earning low wages.

Other Labor Market Changes

A somewhat different aspect of labor market change has frequently been discussed in terms of its implications for job quality. Most of the growth in employment over the past twenty years has occurred outside manufacturing, much of it in service industries. Since average hourly earnings are higher in manufacturing than in services, it has been argued that the decline in the share of jobs in manufacturing has contributed to lower overall average hourly earnings. In addition, it has been noted that blue-collar production worker jobs in manufacturing have accounted for a smaller share of new job opportunities than in the past.

In this case there is broad agreement on the facts: the changing employment mix among industries has by itself tended to produce lower average hourly earnings, and the manufacturing production worker share of employment has declined. But these data tell only part of the story. Changes in employment shares among industries have been accompanied by offsetting changes for occupations. That is, while jobs in service industries were growing more rapidly than in manufacturing, jobs in high-wage occupations such as

professional, technical, and managerial jobs were growing more rapidly than jobs in occupations with lower wages, skills, and schooling requirements. This upgrading of occupational categories has tended to raise wages; it has worked in the opposite direction from shifts in the industry employment mix.

Although blue-collar production worker employment in manufacturing has declined as a share of total employment, it should be recognized that these jobs have provided only one route to middle class living standards. Moreover, such production workers jobs provide a route to middle class (or higher) living levels that is much less well suited to the interests and qualifications of entering workers than it was a generation ago. Schooling levels have increased greatly for new entrants to the work force compared with those who are retiring from the work force. Fortunately, adjustments in the labor market have produced job opportunities more closely tailored to the interests and qualifications of young workers, and the contribution of their skills will be invaluable for maintaining competitiveness in world markets and achieving higher living standards.

The difference in schooling levels between recent entrants into the work force and those at retirement age is quite striking. The proportion who did not complete high school is about 12 percent for new entrants compared with about 30 percent for male workers near retirement. For females the figures are 7 percent and 22 percent respectively. The proportion of new entrants who have at least completed college is now over 25 percent for both males and females compared with less than 20 percent for males and about 10 percent for females who are near retirement age. The contrast was even sharper during the 1970s, which may have contributed to lower economic returns to college then.

Interpretation of Labor Market Developments

The data on labor market trends in recent years do not support the view that persistence of poverty is attributable to a deterioration in the quality of jobs. Conditions for the working poor cannot be traced to an increase in the share of jobs that pay low wages. Moreover, changes that have occurred in relative wage positions--such as declines in the relative wages of young workers and those with little schooling and a rise in relative wages for females--reflect a combination of demographic shifts associated with the entry of the "baby boom" generation into the work force and changing relationships between worker qualifications and skill demands.

Experience and Policy. Changes in relative wages that have occurred are in my view appropriately interpreted as constructive adjustments that facilitated the creation of sufficient jobs to absorb the bulge of baby boom entrants, to accommodate the rise in labor force activity of women, and to provide jobs for new immigrants. They do not reflect serious flaws in the labor market or important policy changes. In my view it would be difficult to reverse them through policy changes, such as raising the minimum wage or trying to influence the industrial mix or occupational categories of jobs, and efforts to do so would have harmful side effects.

The feature of labor market trends that has been of overriding importance in influencing poverty and the economic status of the working poor has been slower overall productivity growth, and correspondingly slower real wage growth, than had occurred during the 1950s and 1960s. Factors that have contributed to the slowdown in productivity growth remain poorly understood. Most analysts would

probably agree that more investment would make a contribution--more investment not only in traditional capital, but also in technology and better schooling and skill development. I believe that the main lesson of experience, however, is that the most promising route to significant improvement in the status of the working poor is through increased productivity for the work force as a whole. The policies with the most promise for significantly improving the economic status of the working poor are those that contribute generally to higher productivity and living standards.

Implications for Policy. Labor market developments during the past fifteen to twenty years, as I have interpreted them, point to a dilemma in efforts to develop policies to improve economic circumstances of the poor in general or the working poor in particular. If the working poor could be characterized as people left behind in the labor market while pay for the rest of the work force moved up strongly, such a record of uneven progress would raise questions about why gains were so uneven, and it might serve as a rationale for policies to try to distribute the gains more evenly. However, this does not seem to be a realistic diagnosis of recent labor market trends.

The problem this poses for policy is that efforts to redistribute gains must come largely at the expense of groups whose gains have also been relatively small compared with earlier experience. That is, the most prominent feature of recent experience has been slower wage and earnings growth across the distribution as a whole, not the emergence of identifiable groups who were left behind while others prospered. This does not mean, of course, that policies to improve the economic circumstances of the poor should not be considered. It suggests instead that policies that are considered should be based on a realistic view of labor market developments, and that while policies to raise incomes of the poor by supplementing their labor earnings might play a role, significant improvement at the low end of the distribution is likely to be contingent primarily on raising earnings across the distribution as a whole.

Poverty and Working Poor

As is well known, not only did the overall poverty rate fail to decline further when real wage growth slowed since the beginning of the 1970s, it has been considerably higher during the 1980s than in the 1970s. Even more disturbing is the pronounced rise in the poverty rate for children. Part of the reason for higher poverty rates in the 1980s is cyclical, but this is only a partial explanation. Changes in the demographic composition of families was an important contributing factor, especially for families with children.

One of the most striking changes in the demographic mix of families is the growing share of single mothers among families with children. From 1970 to 1986 the share of husband-wife families declined from 81 to 71 percent of families with children, while the share accounted for by single mother families almost doubled, from 11 to 20 percent. In 1986 the poverty rate for single mother families with children was 46 percent compared with 8 percent for husband-wife families. This change in family composition has contributed importantly to higher recent poverty rates for families as a whole and for children. According to data reported by the Congressional Budget Office, single mother families was the only major household type whose economic status has shown virtually no improvement at the median, and has shown a significant deterioration at both the lowest and the second lowest income quintile levels.

Single mother families with children include many in which the mother works, and poverty status is influenced importantly by whether she works and how much. For single mothers as a group, two-thirds worked during 1986 and almost 40 percent worked year round and full time. For those in poverty, however, about 40 percent worked at some time during the year and only about 8 percent worked year round and full time. The poverty rate for those who worked year round and full time was 9.4 percent; for those who worked some, 28.3 percent; and for those who did not work at all, 81.7 percent. These differences associated with work experience are very pronounced, and they suggest the limitations of policies to raise or supplement wages directly as compared with policies that provide job opportunities in an effort to improve the economic status of this important category of families with children.

Tax Code Proposals and the Working Poor

In one sense, proposals to expand the earned income tax credit and dependent care credits might seem like a straightforward extension of policies already in place. In another sense, however, current proposals represent a very significant new departure from current practice.

They represent a new departure because current policies are limited to reducing tax burdens for low income workers and to taking into account dependent care costs in collecting tax revenues. These new proposals, however, go a big step further by providing a subsidy for work and for child care through refundable credits. Making federal money available in this way poses the danger of encouraging activities that are economically inefficient--activities that would make no sense in the absence of subsidies.

One way of illustrating this danger is to imagine members of a small group arranging to share child care for one another in a pattern coordinated with their part-year or part-time work. Within relevant earnings ranges, each could obtain a wage subsidy, including those providing child care, while each could benefit from refundable credits to cover up to 30 percent of child care costs. This would produce, in an attenuated form, results akin to subsidizing people for taking in one another's laundry, when all doing their own would be economically more efficient.

In considering the potential effects on incomes of the working poor, note that evidence on the effects of current policy is not yet available. The policies enacted in 1986 were not fully implemented until 1988. Moreover, the effects of the earned income tax credit and other changes in the tax code will not be reflected in the income and poverty data that are normally collected on a pre-tax basis. The Census Bureau has only recently completed an analysis of the effects of benefits and taxes on income and poverty for 1986. Analysis along these lines will be essential not only to identify the effects of tax code changes but also to reflect their effects on after-tax incomes. Thus, current proposals for tax code changes are being discussed in the context of data on incomes of the working poor that are seriously out of date because they reflect the earlier tax code.

These proposals also raise questions about their intended effects. If they are intended to encourage work, for example, it would seem that evidence from our experience with negative income tax experiments is relevant. If they are intended primarily to reward work, why should the reward be larger for people with two dependents than one? If they are mainly intended to improve incomes of families with

children, why should they be linked to work? More broadly, how would these proposals relate to the welfare reforms enacted last year and to other government programs?

Policy Suggestions

Finally, there are two modifications in the tax code that I believe deserve consideration. I believe the principle that no net federal taxes should be assessed below low-income thresholds is a sound one. The principle of paying subsidies for work raises new questions, however, and differential subsidies contingent on dependents raise still further questions. Following this reasoning, I believe that the refundable earned income tax credit should be extended to all workers, whether or not they can claim a dependent on their income tax form. Many now ineligible may already contribute support for a dependent and more might if their after-tax income were higher. As members of the working poor they should be treated equitably in terms of the EITC, even though the threshold below which they pay no net federal taxes would, of course, still be determined by their dependents.

The second modification that should be considered is a transition from the current nonrefundable tax credit for dependent care toward either an increase in the personal exemption level for dependent children or a dependent tax credit for low-income families. The erosion of the real value of the personal exemption over time is one element in the rationale for this suggestion. A more important consideration is that special tax treatment for child care expenses in low-income families encourages commercial arrangements for child care when informal arrangements or parental care at home may be preferable for the family and for society as well. The emphasis should be shifted, I believe, to increasing after-tax incomes to low-income families with children. Whether such a dependent tax credit should be made refundable should depend, in my view, mainly on administrative considerations compared with other ways of providing low-income assistance. The amount of the dependent tax credit and the levels of income, the numbers of dependents, and the ages of children at which it should be phased down should probably be set mainly on the basis of affordability.

These suggestions reflect my personal view at the present time based on my interpretation of labor market developments and different income support approaches. Additional data from experience or new evidence may emerge that would lead me to modify these views. The new proposals to improve incomes of the working poor by introducing explicit subsidies through the tax code seem to me seriously deficient in analysis and in evidence to support their adoption.

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Acting Chairman DOWNEY. Thank you, Dr. Kosters.
Mr. Greenstein.

STATEMENT OF ROBERT GREENSTEIN, DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you, Mr. Chairman, and thank you for the opportunity to be here today.

As you know, we have an unusually high poverty rate now for the longest peace time economic recovery in several decades, the rate in 1978 being higher than in any year in the seventies including the recession years of that decade.

As David Ellwood has said, there often is not a recognition of the degree to which the working poor constitute part of the poverty population and the extent to which the ranks have grown. We often have looked at 1987 in terms of poverty figures and compared it to 1978, the reason being that since poverty normally follows the business cycle and rises and falls with unemployment, 1978 is a year when the national unemployment rate was nearly identical to what it was in 1987.

Yet during this period, the number of people who worked but remained poor climbed by 28 percent and the number who worked full-time, year-round but remained climbed by 43 percent. As you, I think, noted in introducing your bill, well over half of the 32 and a half million Americans living below the poverty line live in a family or a household where someone works, 5 million live in a household with a full-time, year-round worker.

Isaac Shapiro at our center has just recently looked at the number of children in these households, and has found that nearly 8 million poor children, nearly two of every three children living below the poverty line, now lives in a family with at least one worker. More than 2 million children live in a family with a full-time, year-round worker.

These figures are in very sharp contrast to the figures for the number of people on AFDC. The number of AFDC recipients has not really changed in 15 years. It is about the same now as it was as far back as 1973.

There are a number of factors here, economic, demographic and changes in public policy that play a role. As a number of witnesses here today have said, wage levels have eroded or stagnated especially for jobs not requiring a college education. The average hourly earnings of private non-supervisory workers were lower in 1987 than in any year since 1970 after adjusting for inflation, it is true. As Mr. Kosters has noted, that does not include fringe benefits.

On the other hand, it seems to me that measuring those is very tricky because health care costs for employers have gone up much faster than inflation without necessarily providing increased health care benefits for workers. In my Center, Blue Cross/Blue Shield just raised their premiums 55 percent.

Suppose I impose a copayment on employees to help make up part of that. Their non-wage compensation will still look like it achieved a big gain, but their purchasing power will actually leave

them worse off than before. So I think some caution is needed in looking at that factor.

Demographics are also very important, more single-parent families. On the other hand, we should not overstate that. Between 1978 and the present, the number of poor people in married couple families—the increase in the number of poor people in married couple families is actually greater than the increase in the number of poor people in single-parent families.

As David Ellwood has mentioned, looking at married couple families, especially when we are talking about the working poor, is very important.

On the public policy front as well, there have been changes at Federal and State level both. Census data tell us that in 1979 nearly 1 out of every 5 families with children that was poor before receipt of government benefits was lifted out of poverty by those benefits, but by 1987 only about 1 out of every 10 such families was lifted out of poverty by government benefits. This is cash benefits. If we include measures of poverty that count noncash benefits, the percentages are different, but the trend is the same, a sharp decline in the proportion lifted out of poverty by government benefits.

I bring this up because those who have been adversely affected the most by changes in government benefit programs at Federal and State levels over the last decade have been the working poor. Much of what has happened is that income limits, especially in AFDC, have eroded not just benefit levels, but income limits have not kept pace with inflation and it is the working poor who have increasingly been removed from the program as that has occurred.

This committee's marvelous green book tells the story. In 1976 a single parent family of four with earnings equal to 75 percent of the poverty line qualified for AFDC in 46 States. By 1987 the family qualified in seven States. In 1976 that family with earnings at three quarters of the poverty line received benefits including food stamps that lifted it above the poverty line in 45 States. Today that is true in one State. In 1976 there were 81 children on AFDC for every 100 children in poverty. Today there are 58 children on AFDC for every 100 children in poverty.

Again, this has hit the working poor families with children more than any other group.

What to do about this. I would strongly endorse the principle that David Ellwood has stated. If a parent works full time, the family should not have to live in poverty. As he noted, I think that goal would be supported by most Americans across the political spectrum. It is consistent with basic American values. I know we recently had a conversation with staff at the Heritage Foundation who were as strong in their advocacy of that goal as anyone who has come before this table today.

One of the most important steps to attain that goal and to, as David Ellwood has put it, to make work pay, would clearly be to enlarge the earned income credit and adjust it by the number of children in a family. As many witnesses have said today, working poor families with several children face a cruel paradox. Family need grows as family size increases, so does the poverty line, so do welfare benefits, but wages do not. The earned income credit is

well suited to deal with this if it can be adjusted by the number of children in a family.

I will not go into the need for that further. Many witnesses have stated that very well this morning. And you have stated it as well as anyone in a number of statements you have made in recent weeks. But I think that adjusting the earned income credit by family size is one of the most important things that the 101st Congress can do to deal with poverty.

I would urge several other smaller reforms in the earned income credit as well. Measures should be taken to make it easier for working families to receive the credit payments in the regular paycheck. I think that Mr. Tauke speaks to that in his prepared testimony. If we want to achieve the goals we are talking about of enabling families to meet their ongoing needs of making work more attractive than public assistance, it makes sense to enable people to receive the credit in their paycheck. Fewer than 1 percent now do. Few know about it. We need to make some changes there.

In addition, we need to make sure that more families are aware of the credit and the need to file a return to get it. Paradoxically because of the Tax Reform Act, the very wise provisions of the Tax Reform Act, many of these families do not owe income tax any more and may now think they do not need to file. If they do not file a return, they do not get the credit. I think that is another issue that Mr. Tauke also speaks to in his testimony. Clearly, if the EITC is to encourage work and reduce poverty, families who report no income tax have to know of its existence.

In the dependent care tax credit area, again I would support very much what David Ellwood said a very minutes ago. It does not seem to me likely at all that the Congress is going to abolish the dependent care tax credit, and it is fairly egregious to have a credit at which most of the benefits go to families at the middle and upper end and the very families who need it most essentially get nothing because it is not refundable.

I very much commend you for including in your bill a provision to make the tax credit refundable.

I think there is also an issue in terms of the debate of whether in principle there ought to be such a credit. If you adopt the argument that there really should not be such a credit, it seems to me hard to distinguish that from a number of other expenses that people incur in order to work, which if they exceed a certain percentage of adjusted gross income, are deductible. I'm not sure how we make that distinction. But in any event, I don't think that Congress is going to abolish the credit. I think the outcry would be pretty great if it did and if we have the credit, it simply has be be refundable.

I would also like to note, because I'm constantly struck by the fact that many people, average person, the media, and, I would guess, the typical Member of Congress as well, years of proposals to deal with poverty and thinks of urban areas, thinks of cities, thinks of what's called the under-class—there's a common view that Government programs to deal with the poor are primarily targeted at the cities.

Proposals to deal with the working poor, such as the earned income credit, are actually disproportionately targeted to rural

areas. As it turns out, the poverty rate for rural America is above the rate for metropolitan America and close to the rate for central cities. More than one of every six people living in rural America are poor, but the characteristics of the rural poor differ from those of the urban poor in that they are more likely to work. Nearly two of every three poor rural families includes at least one worker.

Nearly one in four poor rural families has at least two workers. Some very striking figures here. Seventy percent of all rural poor family heads who aren't ill, disabled or retired—seven of every ten—work during the year. If you take two-parent, rural families who are poor, 86 percent who aren't ill, disabled or retired work during the year.

Even among single parent families in rural areas who are poor—more than half who aren't ill, disabled or retired work during the year. People who do work are much more likely to be poor if they live in rural areas than in urban areas. One very striking statistic—rural black families in which the family head works—28 percent live in poverty.

That means that strategies to aid the working poor, such as your bill and others discussed here today, would disproportionately benefit rural areas. They were helping a larger proportion of the rural poor than of the urban poor, to the extent that they would probably not only alleviate poverty in those areas, they would probably lose for all economies at the same time.

I don't want to make it sound like the impacts aren't significant in urban areas as well. They would be for two reasons. First, over half of all poor family heads in urban areas who aren't ill, disabled or retired do work.

And second, as I think David Ellwood is suggesting, that if you want to attract more people into the labor force, if you really want to further the kinds of goals in your welfare reform bill, they're not going to work in urban areas or any place else unless people can make it by working.

Finally, I'd like to make a few comments on some of the specific legislative proposals. There are a number now—Mr. Petri's bill, your bill, President Bush's proposal. In assessing them, a number of criteria can be used—how much progress proposals make in lifting families out of poverty; whether the proposals are simple or complex; whether some low-income working families inadvertently are made worse off; whether the benefits are well-targeted; and whether there are adverse side effects, such as excessive marginal tax rates that could discourage working.

Mr. Petri, last year, was really, I think, the outstanding leader in Congress on this issue. His bill was one of the first major bills to make a major adjustment by family size. We had some concerns about it; those concerns were primarily addressed in this year's bill, which is more extensive than last year's.

Because of his leadership in this area, I must hesitate to say anything that isn't positive, but I do want to raise two concerns about his bill that I think you need to look at. The first actually is the one you raised in a question to him—the question of complexity. His approach simultaneously adjusts the credit by the number of children in the family and also varies the credit by the age of the children.

I think the subcommittee needs to find out whether that's going to be too complex. If complexity causes some families eligible for the credit to miss out on it, then the intended effect is diluted.

Now specifically—here are two keys—right now, if an eligible family files a tax return and doesn't fill out the lines in the boxes on EITC—which a lot of these families don't understand, they don't have accountants filling out their tax forms for them—the IRS computes the earned income credit for them anyway and sends them a check.

My understanding is that 10 to 15 percent of the families getting the credit get it in that fashion. We have to be sure that we don't make changes that are so complex that IRS throws up its hands and says, we can't compute the credit that way.

Second, we have to make sure we don't make the changes so complex that we can't provide payments in the regular paycheck, rather than just as a lump sum at the end of the year. The other concern that I have about the Petri bill is the repeal of the dependent care tax credit.

Now, the bill has only been out shortly and we need to do more analysis of it, but our preliminary analysis indicates that some families who have dependent care expenses and get the credit now, that some families with incomes as low as $15,000, in 1988 dollars, could actually be worse off than under current law, despite the generous earned income credit expansion.

The Bush proposal also represents an advance over current law and certainly is quite significant coming from the President of the United States. It, too, I think, has several design concerns or problems. I'm particularly concerned that there would be no expansion for families with children age four or over.

Those families, too, need a wage supplement to lift them closer to the poverty line if we're to attain the goal that David Ellwood espoused—that families that work, especially those with a full-time worker, shouldn't have to live in poverty.

Second, there appears to be a serious design flaw regarding work incentives in the Bush plan because it phases down the tax credit for each young child at a 20 percent rate. That looks like—or it appears to us—that for some families—those, for example, with three young children—that when you add in the phase down on the Bush credit, the phase down on the earned income credit, and FICA payroll taxes, that you get a combined marginal tax rate for some families at 80 percent or more. If that's borne out, that's certainly of significant concern.

Finally, the chairman's proposal. As we see it, it avoids the various problems I've just mentioned; provides a substantial increase in the earned income credit for a family size adjustment; doesn't restrict that to families with young children; not only makes the dependent care credit refundable, but restructures it so it's better targeted; does not increase the 38 excessive marginal tax rates.

While all of the bills represent important advances over current law in various ways, our analysis at this juncture is that the Downey bill stands out as the best-designed proposal. Having said that, there is one aspect of the design of the bill that, in my own view, might be improved further.

You have only two tiers—families with one child and families with two or more children. Other plans, such as the Petri plan, have as many as four tiers. If the family size adjuster is to lift larger families and their children closer to the poverty line and to try to achieve David's goal that if you work you shouldn't be poor, then I think it would be desirable to recognize the needs of families with more than two children and I'd recommend adding a third tier to your plan.

I think that could be done without increasing the cost, since there are more families with one child, as I understand it, than with three or more children. A modest reduction in the credit increase you've provided for families with one child could finance a larger increase for families with three or more children.

Finally, I would like to close on the same note that David closed on. We need to be careful not to think that this is the full answer and that these bills alone will bring families with a full-time worker to the poverty line. A couple of figures you may find startling—under your bill, a family with one child and a full-time minimum wage worker would still fall $2,000 below the poverty line. A family with two children, a family of four with two children and a full-time minimum wage worker would fall $4,300 below the poverty line.

I'm not suggesting changing your bill to make the credit so large that by itself it would raise families to the poverty line. To do that, you'd have to have a credit of 40 percent for families with one child, 70 percent for two-parent families with two children. Credits of that magnitude would be prohibitively expensive. They would inevitably result in extremely high marginal tax rates.

They can't practicably be designed or afforded, but that leads me to the same place, I think, it led Professor Ellwood—the right policy is a coordination of an increase in the minimum wage and adjustment of the earned income credit by family size.

Finally, I would also note that there are other issues—lack of health care coverage for many working poor families and also the issue of the lack of affordable, adequate, quality child care for many low-income families. They're really outside the scope of the bill; in many ways, they're outside the jurisdiction of this Committee.

They would need to be dealt with separately, but in a larger perspective, I think they also need to be viewed as part of the larger goal of making work pay and making sure that families with a full-time working parent don't have to live in poverty. Thank you.

[The statement of Mr. Greenstein follows:]

TESTIMONY OF ROBERT GREENSTEIN
DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES
before the
SUBCOMMITTEE ON HUMAN RESOURCES
of the
HOUSE COMMITTEE ON WAYS AND MEANS

February 28, 1989

I appreciate the invitation to appear before the Subcommittee today. I am Robert Greenstein, director of the Center on Budget and Policy Priorities, a non-profit research and analysis organization here in Washington, D.C. A major part of the Center's work is devoted to examining federal and state policies and programs that affect lower income households. The Center is primarily supported by grants from foundations.

Poverty, Children, and the Working Poor

Today, despite one of the longest economic recoveries in recent decades, poverty remains at high levels. While poverty has declined during the current recovery, it has declined slowly, leaving the nation with a much higher poverty rate than in the 1970s. In 1987, the fifth year of the recovery, the poverty rate was substantially higher than in any year of the 1970s -- including the deepest recession years of that decade.

A particularly interesting and unsettling comparison can be made by examining poverty rates for 1978 and 1987. Although the national unemployment rate was nearly identical in both years and poverty rates normally follow the business cycle, the poverty rate was substantially higher in 1987. Eight million more Americans were poor in 1987 than in 1978. About three million of this increase can be attributed to population growth, but the remaining five million -- which constitutes the majority of the increase -- is due to a higher poverty rate.

Not only is poverty more widespread now than it was a decade ago, but it is also more severe. The average poor family falls farther below the poverty line, after adjusting for inflation, than at any time since the 1960s. The proportion of the poor falling into the category we might term the "poorest of the poor" -- those with incomes below *half* of the poverty line (or below $4,528 for a family of three in 1987) -- was higher in 1987 than at any time in more than a decade.

These trends are particularly marked among children. From 1978 to 1987, the number of poor children climbed by more than three million. There has been especially rapid growth in the number of children falling into the ranks of the poorest of the poor (i.e., living in families with incomes below half the poverty line). From 1978 to 1987, the number of poor children falling into the poorest of the poor category exploded, rising by 66 percent. The number of black children falling into this category rose by 54 percent; the number of white children in this category jumped 69 percent.

Hearing these figures, the first reaction of many Americans may be to assume that the increases in poverty since the late 1970s were fueled by a surge in black inner city poverty, concentrated among black single-parent families on welfare. Such a perception would be mistaken, however. The growth in poverty in recent years has been far more widespread.

- It has occurred among whites as well as blacks: the increase in the number of white poor since 1978 is two and one half times the increase in the number of black poor.

- It has occurred among two parent families as well as among single-parent families: the increase since 1978 in the number of poor people living in two-parent families is greater than the increase in the number of poor people in single-parent families.

- It has occurred in rural as well as in urban areas: the nonmetropolitan poverty rate rose about as fast during this period as the central city poverty rate and is nearly as high as the central city rate.

And most relevant for today's hearing, poverty has risen markedly among people who work.

The Growth in the Ranks of the Working Poor

Between 1978 and 1987, the number of people who work but remain poor climbed by nearly two million, or 28 percent. The number who work full-time year-round but remain poor climbed even faster, rising by 43 percent.

In 1987, some 32.5 million people lived below the poverty line, according to official Census Bureau poverty data. Of these, approximately 18 million -- or more than half of the poor -- lived in a household in which at least one household member worked. Approximately five million lived in a household with a full-time year-round worker.

Since some of those who did not work were elderly, the proportion of poor children who live in a household with a worker is even higher. More than eight million poor children -- or nearly two of every three poor children -- lived in a family with at least one worker in 1987. More than two million children lived in a family with a full-time year-round worker.

These increases in the ranks of the working poor stand in sharp contrast to the lack of growth in the number of families and children on public assistance. The number of recipients in the Aid to Families with Dependent Children program has not changed appreciably in 15 years. It is about the same now as it was as far back as 1973.

Factors Contributing to the Growth in the Ranks of the Working Poor

There appear to be three principal factors behind the increases both in poverty in general and among working families in particular. The factors include: economic shifts, demographic changes, and changes in government benefit programs. While there is continuing debate over the relative importance of these factors, there is broad agreement that all three factors have played a role.

On the economic front, wage levels have eroded or stagnated, especially for jobs not requiring college education. The average hourly earnings of private nonsupervisory workers were lower in 1987 than in any year since 1970, after adjusting for inflation.

On the demographic front, the increase in the proportion of families headed by a single parent has contributed to increases in poverty. (This factor should not be over stated, however; the increase since 1978 in the number of poor people living in married-couple families has been greater than the increase in the number of poor people living in single-parent families.)

On the public policy front, retrenchments in benefit programs at both federal and state levels have contributed to the increase in poverty. Census data show that in 1979, nearly one of every five families with children that was poor before receipt of government cash benefits was lifted out of poverty by these benefits. By 1987, only about one in every ten such families was raised from poverty by government assistance. This sharp decline in the anti-poverty impact of government benefit programs is also found when alternative measures of poverty that count non-cash benefits as income are used.

Among those hardest hit by the retrenchments in benefit programs have been low income families that work. More than half of the low income working families that were on AFDC prior to the 1981 federal budget reductions were removed from the program by those changes. Major reductions over the years in state AFDC income limits and benefit levels (due largely to failure to keep pace with inflation) also have primarily affected the working poor.

Indeed in 1976, a single-parent family of four with earnings equal to 75 percent of the poverty line qualified for AFDC in 46 states. By 1987, the family qualified in only seven states.

Similarly, in 1976, the single-parent family of four with earnings at 75 percent of the poverty line received benefits (including food stamps) that lifted it above the poverty line in 45 states. Today it is lifted above the poverty line in just one state.

Finally, in 1976 there were 81 children on AFDC for every 100 children in poverty. In 1987, there were just 58 children on AFDC for every 100 children in

poverty. Much of the decline occurred among children in families with a working poor parent.

Needed Action

One of the most significant actions the 101st Congress could take to alleviate poverty, especially among children, would be to adopt measures designed to "make work pay" (to use David Ellwood's term). These measures should primarily be outside the welfare system.

Like David Ellwood, I would recommend that a fundamental national goal be established: *if a parent works full-time year-round, the parent and his or her children should not have to live in poverty.* I believe this goal would be supported by most Americans across the political spectrum. It is consistent with basic American values. I would note, as an example of the broad consensus developing around this principle, that in recent conversations we have had with staff of the Heritage Foundation, they have expressed strong support for this goal.

If we can attain this goal, we will lift many working poor families with children out of poverty. Instituting reforms to "make work pay" could also have a significant work incentive effect, bringing more people into labor markets that are tightening in many areas and making work relatively more attractive as compared to public assistance or various endeavors in the underground economy.

The Earned Income Tax Credit

In this vein, one of the most important steps Congress could take to "make work pay" would be to enlarge the earned income tax credit for working poor families with children and to adjust it by the number of children in a family.

Today, working poor families with several children face a cruel paradox. Family needs increase as family size grows. Recognizing this fact, the poverty line rises with family size. Welfare benefits also increase with family size. But wages do not.

As a result, large working families with several children are more likely to be poor than are smaller working families. In addition, those large families that are poor are likely to fall further below the poverty line than smaller families that are poor. Furthermore, as family size increases, low paid work becomes less and less competitive with welfare.

What is needed is a wage supplement for working poor families that is geared to family size. The earned income tax credit (EITC) is well-suited for this purpose. It can be restructured to reflect the number of children in a family.

The earned income credit is available only to working poor families in which parents live with and support children. Adults who do not work, as well as fathers who have left their families, do not qualify. The credit thus is widely regarded as being strongly "pro-work" and "pro-family."

In addition to being a well designed element of tax and poverty policy, the earned income credit enjoys support from across the political spectrum. One of the first calls to establish an earned income credit came in 1972 from the then-Governor of California, Ronald Reagan. The credit was championed in Congress in the mid-1970s by Russell Long, then chairman of the Senate Finance Committee, and enacted in 1975. Expansion of the credit was proposed by the Reagan Administration as part of its tax reform package in 1985, enlarged upon by the Democratic House, further enlarged upon by the Republican Senate, and then signed into law by the President as part of the Tax Reform Act of 1986.

In the past two years, the idea of expanding the earned income credit through family size adjustments has gained a growing and impressive number of both conservative and liberal adherents. Its virtues have been extolled by President Reagan's Task Force on Families (staffed by then-White House aide Gary Bauer), a number of members of Congress of both parties, leading poverty analysts such as Robert Reischauer and David Ellwood, and organizations as disparate as the Children's Defense Fund and the Heritage Foundation. (The Heritage Foundation has recently been

circulating a proposal to adjust the credit by family size that would phase in over four years, reaching a cost of $4.5 billion in the fourth year.[1])

Several other smaller reforms in the earned income credit should also be considered. Measures should be taken to make it easier for working families to receive the credit payments in their regular paychecks. The Internal Revenue Code has long allowed workers to receive credit payments throughout the year in their regular paychecks if they so request. However, few workers appear to be aware of this option. More than 99 percent of those receiving the credit obtain it as a lump sum (in the form of a tax refund) after the end of the year. For many families, the credit is likely to be more effective -- both in helping to meet ongoing living expenses and in increasing the attractiveness of work -- if it is reflected in a worker's regular paychecks.

Second, an arcane rule in the IRS code that precludes some AFDC working families from receiving the credit should be repealed. Currently, if a mother receives less than half of the family income from earnings -- and more than half from AFDC -- she is ineligible for any EITC benefit. However, if she receives more than half of the family income from earnings, she is fully eligible for the credit. Thus, a mother receiving 51 percent of her income from earnings and 49 percent from AFDC may qualify for a credit of several hundred dollars. But if her employer reduces her hours of work slightly, and earnings edge down to 49 percent of income with AFDC comprising 51 percent, her credit goes to zero. This mother would then receive no EITC benefit whatsoever to help offset the regressive payroll taxes withheld from her paycheck.

Finally, the Congress should endeavor to ensure that low income working families with children are aware of the credit and of the need to file a federal income tax return to receive it. Paradoxically, the low income provisions in the Tax Reform Act of 1986 may cause many working poor families to lose the EITC benefits they have received in the past. The Tax Reform Act removed five or six million low income households from the income tax rolls. As a result, many of these households are now receiving (from their employers) W-2 forms for 1988 which show no federal income tax to have been withheld last year. Many of these poor working families may fail to file an income tax return as a result. Yet if they do not file, they lose the EITC benefit they may have earned.

If the EITC is to encourage work and reduce poverty, working families too poor to owe income tax must know of its existence and the need to file a federal tax return to receive it.[2]

Child Care Tax Credit

Raising family incomes through such measures as an expanded earned income credit is very important. However, other measures are also needed to "make work pay." If a low income family incurs substantial child care costs, its disposable income may still fall very far below the poverty line and the advantages of working may be diminished or negated.

The federal income tax code currently includes a dependent care tax credit that provides a tax subsidy to reduce the child care costs of all working families except those in one group -- working poor families. The credit thus provides the least help (or more accurately stated, no help) to those who need it most.

The reason for this state of affairs is that the credit if not "refundable." Those too poor to owe income tax receive no credit. By contrast, families at higher income levels do receive the credit, and through it they receive a federal child care subsidy. Due to this situation, the bulk of federal child care support is provided through the tax system and goes to middle and upper income families, not to poor ones. The obvious

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1. The adjustment in the Heritage proposal would be based on the number of young children in the family.

2. In recent weeks, the Center on Budget and Policy Priorities has launched a campaign to publicize the credit and the need for low income working families to file a federal income tax return. The campaign involves governors, mayors, business and labor groups, religious and charitable organizations, and others. Public information efforts are needed on a much larger scale, however.

solution is to make the dependent care tax credit refundable, a proposal that has been endorsed by President Bush.

The Urgency of the Need to Assist These Families

Steps such as enlarging the EITC and adjusting it by family size, and making the dependent care credit refundable, should be accorded very high priority. I believe they should be among the leading domestic priorities for the 101st Congress.

Low income families with children have fared poorly in recent years. A recent Congressional Budget Office analysis tells a disturbing story: from 1979 to 1987, the average income of the poorest fifth of families with children *plunged 21 percent*, dropping $1,757, after adjusting for inflation. The next-to-the-poorest fifth of families with children also fared badly; their average income fell $1,584. By contrast, the average income of the middle fifth of families with children stayed essentially the same, rising $61 (a scant 0.2 percent). Meanwhile, the average income of the wealthiest fifth of families with children rose $7,334 (or 11.2 percent).[3]

The unsettling aspect of these data is not that those at the top are doing so much better, but that at the same time this has been occurring, poor families with children have been growing significantly poorer.

Institution of measures to "make work pay", such as those being discussed here today, can help to address this unfortunate situation, at least among working poor families.

Rural Impacts

These measures can be especially important in rural America. Although the focus of attention recently has largely been on urban poverty, the poverty rate for rural America is considerably higher than the rate for the metropolitan areas of the U.S. -- and is not far below the poverty rate for the nation's central cities. More than one of every six people living in the nonmetropolitan U.S. lived in poverty in 1987.

One of the most striking characteristics of rural poverty is the extent to which the rural poor work. *Nearly two of every three poor families living in rural areas include at least one worker, and nearly one in four have two or more workers.*

Many of those rural poor families that do not have any workers are families in which the only adults are elderly or disabled. When we examine the characteristics of the people who head rural poor families -- and who are not elderly, disabled, or sick -- we find a very strong emphasis on work.

- In 1987, some 70.5 percent -- or seven out of ten -- rural poor family heads who were not ill, disabled, or retired were people who worked during the year.

- An even higher proportion of the family heads in poor rural two-parent families -- 85.6 percent, or more than five of every six, who were not ill, disabled, or retired -- worked during the year.

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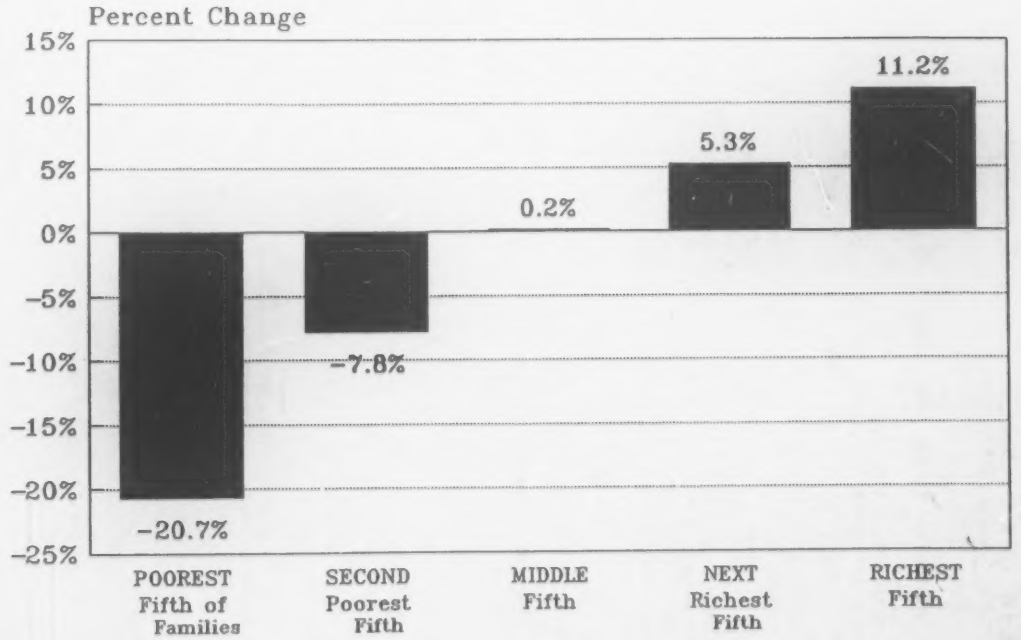
3. The CBO analysis uses an alternative inflation measure (the CPI-X1) that shows somewhat less inflation over time than the more widely used "official" Consumer Price Index. Had the official CPI been used, the drop in income for poor families would have been even greater.

Other CBO analyses also include adjustments in family income levels to reflect changes over time in family size. When this is done, the results are nearly the same as those cited in the text above; the average income of the poorest fifth of families with children is found to have fallen 21.3 percent from 1979 to 1987; the average income of the middle fifth of families with children is found to have edged down by 0.4 percent; and the average income of the top fifth of families with children is found to have grown by 12.9 percent. These studies essentially demonstrate that regardless of which methodology is used, the income gaps between rich and poor families with children (and also between rich and middle income families) are found to have increased substantially since the 1970s.

Change in Average Income of Families with Children

By Quintiles, 1979–1987



Source: Congressional Budget Office, based on Census Bureau data.

Change in Average Income of Families with Children

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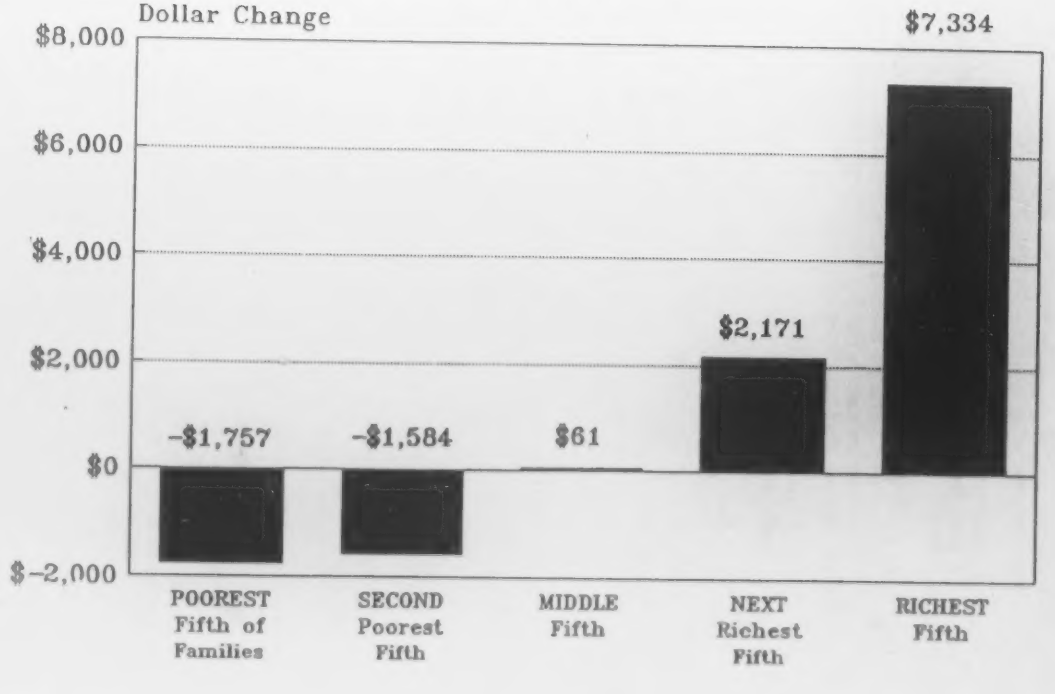

Source: Congressional Budget Office, based on Census Bureau data.

- More than half of those who head poor single-parent families in rural areas and who were not ill, disabled, or retired worked during the year.

Most poor families in rural areas thus are working poor families. Moreover, in rural areas, those who work are much more likely to be poor than are workers who reside in urban areas.

Indeed, the Census data show that poverty rates are higher in rural than in urban areas for all types of working families -- for both white and black working families, for families with a full-time worker and for families with a part-time worker. The poverty rates are especially shocking for black working families in rural areas.

- In 1987, some 28 percent of all rural black families in which the family head worked -- more than one in every four -- fell below the poverty line.

- More than 14 percent of all rural black families in which the family head worked full-time year-round -- or one in every seven -- were poor.[4] (These data are for 1986; comparable data for 1987 are not yet available.)

From these data, a conclusion clearly emerges: strategies to aid working poor families -- and to "make work pay" -- would *disproportionately benefit rural areas*. Such strategies would raise the incomes of a larger fraction of the rural poor than of the urban poor, since a larger fraction of the rural poor work.

Moreover, because the working poor constitute a considerable proportion of the population in many rural areas, measures to "make work pay" can not only have a substantial impact on rural poverty rates, they may boost rural economies at the same time.

Urban Impacts

In the cities, the proportion of the poor that work is somewhat smaller than in rural areas. Nevertheless, it is still substantial. More than half (55 percent) of all poor family heads in urban areas who are not ill, disabled, or retired work during the year.

The effects of the "make work pay" reforms thus are likely to be large in the cities, as well. Furthermore, a key policy goal in the inner city should be to transform the working poor more into role models, and to make them seem less like "chumps" who work all day at jobs that pay little more than what can be obtained through public assistance or minor hustling. A strategy to make work pay would not only alleviate poverty among many poor working families in the inner cities, it might also prove, over the long run, to do as much (or more) to affect attitudes and norms in such communities as the exhortations for changes in values now so widely sounded.

Specific Legislative Proposals to Aid Working Poor Families

Several proposals have recently been advanced to expand the earned income credit, generally through a family size adjustment. Among these are a proposal introduced last week by Rep. Thomas Petri, the proposals of President Bush, and the bill introduced earlier this month by Reps. Downey, Miller, and Lewis and Senator Gore.

In assessing the various proposals, a number of criteria can be used. Among them are: how much progress a proposal makes in raising a family with a full-time working parent to the poverty line; whether a proposal is relatively simple or whether it would be overly complex to administer; whether a proposal reduces benefits for some low income working families; how well the benefits in the proposal are targeted; and whether the proposal avoids features that could have adverse side-effects, such as extremely high marginal tax rates that could discourage work.

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4. Despite the very high rates of poverty among rural black working families, most rural poor working families -- some 78 percent -- are white. In addition, most rural poor working families are married-couple families (some 65 percent).

Last year, Rep. Petri (and Senator Rudy Boschwitz) introduced a bill to expand the EITC and adjust it by the number of children in a family. This bill represented an important advance and was the leading EITC reform bill in 1988.

The bill did have a few shortcomings, including the fact that some families would have received a smaller credit than under current law. The new proposal introduced last week by Rep. Petri remedies these problems. It expands the credit substantially more than last year's proposal did. It also calibrates the family size expansion to the age of the children, with the largest increase being for children under six (and no adjustment for children over 15).

The earned income credit features of this bill are attractive. There is, however, a need to explore whether an approach that simultaneously adjusts the credit by the number of children in a family and also varies the credit by the age of the children -- as the bill does -- will be too complex. If complexity causes some families eligible for the credit to miss out on it, then the intended impact of an EITC improvement can be diluted.

For example, if an eligible family files a tax return but does not fill out the lines on the tax return relating to the EITC, the IRS will compute the family's credit and send it a check. It is my understanding that some 10 to 15 percent of all families receiving a credit fall into this category. It is important not to make the EITC so complex that the IRS can not continue to perform this valuable service.

While the earned income credit features of the Petri bill are attractive, it does contain another, less attractive feature: it repeals the dependent care tax credit. This could make some families with incomes as low as $15,000 (in 1988 dollars) worse off than under current law, despite the generous earned income credit expansion.[5]

Moreover, no recognition would be provided for child care expenses that these families have to incur in order to work outside the home.

The Bush Proposal

The Bush proposal also represents an advance over current law. Unfortunately there are also some problems in its design. The proposal provides a new credit of up to $1,000 for each child under the age of four. However, there is no expansion of the credit for families whose children are age four or over. Families with older children also need an increase in the credit to lift them closer to the poverty line -- and to move us toward the goal that if a parent works full-time year-round, the family and its children should not be poor. In this area, the Petri proposal is much superior to the Bush plan.

On the other hand, the Bush proposal makes the dependent care tax credit refundable, an important advance.[6] In this area, it is preferable to the Petri bill.

The Bush plan appears to have a serious design flaw regarding work incentives. It requires that the new tax credit for young children phase down at a 20 percent rate for each child in the family. This would create confiscatory marginal tax rates *of more than 80 percent* for some large families.

For example, if a family had three young children and had income between $11,000 and $13,000 in 1990 (or an income between $15,000 and $20,000 in 1994, when the credit would be fully phased in), it would lose nearly 78 cents in federal taxes for

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5. For example, consider the case of a family of three with one preschool child and income of $15,000 in 1988. If the family's income keeps pace with inflation, it will be about $17,000 in 1991, the year the Petri bill takes full effect. In that year, the family's earned income credit would apparently be about $350 greater than under current law, but the family could lose a dependent care credit of up to $624 if it had child care costs of just $200 a month, a relatively modest amount.

6. A number of other bills introduced by other Members of Congress would also make the dependent care tax credit refundable.

each additional dollar it earned;[7] when state income taxes are figured in, the overall marginal rate would be likely to exceed 80 percent.

The Downey Proposal

The Downey bill avoids these problems. It provides a substantial increase in the earned income credit through a family size adjustment and does not restrict this to families with young children. It makes the dependent care credit refundable and also restructures the dependent care credit to defray more of the child care costs of low income working families. It is well targeted, and does not allow increased benefits to go to families much above $20,000, as some other proposals would. It does not create excessive marginal tax rates or have other adverse side-effects. While all of the other bills represent important advances over current law in various ways, the Downey bill stands out as the best designed proposal introduced to date.

Having said that, there is one aspect of the design of the Downey bill that I believe could be improved. Unlike some of the other proposals, the Downey plan provides only two different EITC benefit tiers: one for families with one child and one for families with two or more children. Other plans provide more tiers: the Petri plan, for example, has four tiers, covering families with one, two, three, and four or more children.

If an EITC family size adjustor is to help lift larger families and their children closer to the poverty line, it should recognize the needs of families with more than two children. I would therefore recommend adding a third tier to the Downey plan -- for families with three or more children. This could be done without increasing the cost of the bill by modestly lowering the bill's benefits for families with one child. (There would still be an increase over current law in the credit for families with one child.) Since there are more families with one child than with three or more children, a modest reduction in the bill's credit levels for the one-child families should free up enough funds for a more substantial credit enhancement for families with three or more children.

Other Steps to "Make Work Pay"

Before closing, I would like to note that the improvements discussed here in the earned income credit and the dependent care credit will not, by themselves, achieve the goal of ensuring that a family with a full-time working parent escapes from poverty.

For example, the Downey bill would provide a maximum credit of $1,430 next year to a family with one child, an increase of close to $500 over current law. Yet if the family had full-time minimum wage earnings, it would still fall nearly $2,000 below the poverty line in 1990.

Similarly, the maximum credit under the bill for a two-child (or three-child) family would be $2,043, which would leave a family of four with full-time minimum wage earnings some $4,300 below the poverty line.

This is not to suggest that the credit should be expanded vastly beyond the levels in the Downey bill. Rather, the point is that the earned income tax credit alone cannot assure that full-time working poor families are raised to the poverty line. To lift a family of three with full-time minimum wage earnings to the poverty line would require an earned income credit *of more than 40 percent*. To lift a family of four to the poverty line would require a credit *of more than 70 percent*. Credits of this magnitude would be prohibitively expensive and would almost inevitably result in extremely high marginal tax rates being imposed on families whose incomes placed them in the credit's "phase down" range. In short, credits of this size cannot practicably be designed or afforded.

As a result, lifting a family with full-time minimum wage earnings to the poverty line requires a combination of two policies: an expansion of the earned income credit and an increase in the minimum wage.

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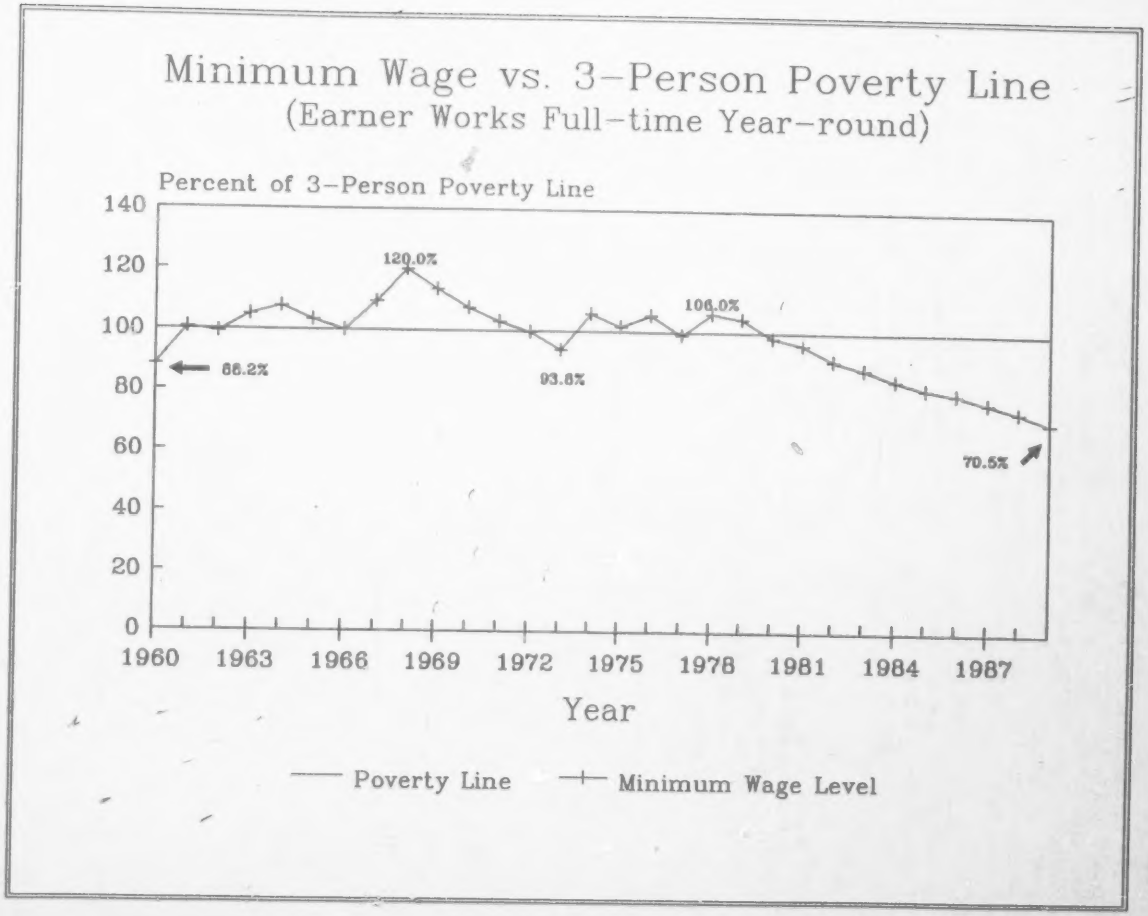
7. The family would lose 60 cents on the dollar due to the phase down of the children's tax credit and 10 cents on the dollar due to the phase down of the earned income credit. It would also pay 7.65 cents in payroll taxes. If the family also owed federal income tax -- which would be the case for some families in the applicable income range in 1994 -- the combined marginal tax rate would generally exceed 95 percent.

Throughout most of the 1960s and 1970s, the minimum wage was set at a level that lifted a family of three with a full-time year-round worker slightly above the poverty line. Now it leaves such a family far below the poverty line. If the minimum wage were returned most or all of the way to its value of the 1960s and 1970s, it could raise families of three closer to the poverty line. Then an expanded EITC with a family size adjustment could get the three-person families the rest of the way there and raise larger families most or all of the way to the poverty line, as well.

Indeed, the conclusion we at the Center have come to is the same as that reached by Professor Ellwood in his noted book *Poor Support: Poverty in the American Family*. Only a combination of an EITC expansion and a minimum wage increase can get us to the goal of assuring that if a parent works full-time year-round, the parent and his or her children will not be impoverished.

Finally, I would note that the tax credit changes discussed in this testimony are a critical ingredient -- but not the whole -- of the "make work pay" agenda . Tax credit changes do not address the lack of health care coverage for many working poor families or the difficulties many of these families face in finding affordable child care of adequate quality. While these issues are beyond the scope of this testimony, they are very important, nonetheless. To fully "make work pay," these matters also require Congressional attention.


Minimum Wage vs. 3-Person Poverty Line
(Earner Works Full-time Year-round)
Percent of 3-Person Poverty Line
140
120
100
80
60
40
20
0
120.0%
106.0%
86.2%
93.6%
70.5%
1960
1963
1966
1969
1972
1975
1978
1981
1984
1987
Year
Poverty Line
Minimum Wage Level

Acting Chairman DOWNEY. Thank you, Mr. Greenstein, for your excellent analysis, Mr. Ellwood and Dr. Kosters as well.

Dr. Kosters, if I could begin with you. You mentioned in your analysis of H.R. 882 that you thought the size of the credit that we provide would cause economic dislocation. Could you be more specific?

Mr. KOSTERS. Yes. In my oral summary, I said I thought it would cause economic inefficiency. In my written testimony, I describe that in a little bit more detail. What I say there is that one could imagine a set of circumstances under which a group of people would get together and share each other's child care. They would have some part-time or part-year jobs in addition, and exchange child care services. In this case, the person providing the child care, and paid for it, would be able to take advantage of an earned income tax credit. Those who would be paying for it would, of course, get it financed in part by dependent care tax credit.

Now, the purpose of this example is not so much to suggest these particular arrangements are likely to be wide-spread. The purpose instead is to illustrate how economic efficiency occurs, and how economic waste occurs in the economy as a whole. The example really illustrates my concern about tax proposals that significantly subsidize people for working.

I'm all for working, but I'm not for make-work schemes that are financed by the Federal Government.

Acting Chairman DOWNEY. Well, how could you possibly suggest that the EITC is a make-work scheme. What would lead you to even remotely consider it as such?

Mr. KOSTERS. The current EITC, I do not think suffers from this kind of defect. That is, what it does, in effect, is that below some low-income threshold, it refunds taxes that are paid in another form, primarily Social Security taxes. So essentially, a person is in the position then of getting no net subsidy and no net tax payments—or at least close to that situation for many people.

Your proposal, however, says we are going to subsidize each hour of work by an earned income tax credit. That gives you a form of a net negative tax. That is a proposed approach that some people favor. I agree that there are also problems with the way our current welfare system is administered. But my point about this proposal is that it can encourage economic inefficiency and waste, and that the waste will be worse the higher the rates of the subsidy. It will also be worse for people with more children than with fewer children and so on, as the proposal is currently structured.

Acting Chairman DOWNEY. Now, help me out a little bit if you would.

If you work full-time today at a minimum wage and you're a family of four, you get some $6,960. That leaves you $4,700 below the poverty line. Is that a desirable situation in our country?

Mr. KOSTERS. That's not a desirable situation. It's very fortunate that there are very few people in that category—that is, most of the people who are working at the minimum wage are people who are young, who are single, and who are in school. They're part-time workers. Most of the people working at the minimum wage share these characteristics.

Certainly, there are some people who work at the minimum wage, year-round and, presumably usually full-time, who would not be able to raise a family of four out of poverty. Some of the people who earn such low wages may earn it in connection with some other kind of activity. They may manage an apartment, for example, and get free rent in addition, which is not counted in their wage or money income.

You know, it's interesting when I've look at this data carefully, I have never found a group in an age and schooling category where there was not a significant number of people who make less than the minimum wage. This includes people with 4 years of college or more and 10 or 20 years of work experience. In groups of that kind, there's almost always someone who earns less than the minimum wage.

I don't know whether that's mainly a measurement problem. I'm prepared to believe that there are people actually in these circumstances. We should not, however, over-estimate the extent to which they're prevalent in the economy. And, in particular, it seems to me, we should not jeopardize jobs and work experience for young workers in order to address the relatively few cases where that might occur. I would personally prefer, for example, something like dependent tax credits to improve their lot, rather than raising the minimum wage.

Acting Chairman DOWNEY. The estimates are that there are 5.5 million persons who live in families where there is someone working full-time. That's not an insignificant number of people.

Mr. KOSTERS. Well, that's true. But we need to recognize, it seems to me, that the world is complex, that there are all kinds of different circumstances, some are farmers affected by last year's drought. Some of these people may have tried their own business for a while. They worked year-round, full-time, and earned some money at a wage and salary job, but their annual earnings were low. Certainly, starting a restaurant or whatever has its risks.

It seems to me we should be willing to live with circumstances in which people take those risks, and sometimes have low measured income that leaves them in poverty for a year. This is not all that that group consists of, but we need to recognize that some portion of its people are in that kind of situation.

Acting Chairman DOWNEY. Mr. Ellwood.

Mr. ELLWOOD. I'm actually a little bit surprised by some of Dr. Kosters' remarks, just because it seems to me, this bill or this kind of approach really is a dream for those who care about work, who think that's a critical value. Again, you said that one of the problems with this is that it creates additional payments and incentives to people to work and so on. This should be troubling.

The welfare system—we can't decide whether to raise benefits to reduce poverty among children or lower benefits because we're worried about dependency. With this, there's no problem. With this, the more you pay, the greater incentive there is to work. The example you provided of inefficiency was some bizarre arrangement of different people getting together, trying to exploit the system.

Well, sure, there are some very odd configurations, but it's not like—what's the alternative. Are you really willing to say that you

are not willing to stand up for the principle that if you work, you shouldn't be poor? It seems to me that that ought to be fundamental and if it's not fundamental, then we really are dooming 20 percent of our children to poverty just as they are now.

Acting Chairman DOWNEY. Did you want to respond, sir?

Mr. KOSTERS. I think the idea that people who work should not be poor is a very fine slogan. I don't think it's a very good policy, however. It seems to be very difficult to administer or to apply in practice. Even if this bill were passed, some who work would still be poor. I think we should be realistic about that.

In fact, some of the incentives that would be required—the 70 percent, 80 percent rates that Mr. Greenstein mentioned—illustrate the problems of relying too extensively on wage subsidy programs. I would ask if this is such a great program at a 30 percent rate, why would we, in fact, shrink, from the 70 percent rate or 80 percent rate? Surely there must be something more involved than simply the budget costs of that kind of program. I think that the fact of the matter is that the amount of waste would be so obvious and apparent under those circumstances that there would be no fig leaf to hide behind.

Acting Chairman DOWNEY. Mr. Greenstein.

Mr. GREENSTEIN. I would certainly view this quite differently. It seems to me that what's striking is how much simpler that goal is to administer and attain than the kinds of things we try to do through the welfare system where we have a variety of conflicting forces working in opposite directions.

I think the reason we don't want to do a 70 percent credit is both because it would be very expensive and we need this to be more of a shared burden between the public and private sectors, and because if you have a 70 percent rate on the way up, you might need to have a 70 percent rate on the way down, and that would create very high marginal tax rates on the way down.

What is striking is that I don't recall that we had tremendous waste in the 1960's and 1970's when, as David Ellwood and Bob Reishower and others have noted, full-time, year-round work at the minimum wage, raised a family of three to the poverty line.

If you were, as David suggested, to have a minimum wage at that level—and we're not about to, that's above the levels of the bills before the Congress—but if you were to have that, that would raise a family of three back to the poverty line with full-time, year-round work, and an earned income credit, probably in the nature of the sort that you've introduced, then would raise the larger families with more children with a full-time worker to the poverty line and that could be done without anybody going to a welfare office, who was working full-time.

It would actually be quite simple to administer. I'd also note that I share what I take as your view that this is a pretty serious problem and there are a lot of people involved. As we noted, those 5 or 5½ million people include more than 2 million children who live in families that are poor but have a full-time worker.

I'd also note that when you look at people who were paid minimum wage or less, who were hourly workers or salaried workers—not people owning their own businesses—70 percent of them are age 20 or over; 50 percent of them are age 25 or over; and when

you also look, not just at people at the minimum wage, but at people in that zone above the minimum wage that would be affected by a minimum wage increase.

In other words, if the minimum wage had kept pace with inflation, it would now be somewhere in the vicinity of $4.50 an hour. If you look at people—and I think it's 1987 are the figures I have—who had hourly wages or a salary rate of $4.35 an hour or less—that is to say, those who would be directly or, in many cases, indirectly affected by restoration of the minimum wage, it turns out that nearly three-fifths of all workers paid an hourly or salaried rate, who were in households that are below the poverty line, fall into that category of $4.35 an hour or less.

So, we really are talking, I think, about having a significant impact, by these kinds of policies, on the very people that you're talking about.

Mr. KOSTERS. May I make a brief comment about the minimum wage? Reference is very frequently made to the fact that the real level of the minimum wage is much lower now than it was during the 1950's and 1960's, and that's certainly correct.

However, there have been some other things that have changed a great deal also. So, we should expect the effects of an increase in the minimum wage now to be quite different than those of a minimum wage at 50 percent of the average wage at that time.

For example, at the present time, at least three-fourths of minimum wage workers are working in retail trade or services. During the 1950's, hardly any workers in those industry groups were covered by the Federal minimum wage. When the minimum wage was introduced initially into those industries in the 1960's, a special lower minimum wage was applied to the newly-covered workers. So, coverage has expanded enormously since that time . It has expanded, in particular, for the two industries there that include most low-wage workers.

A minimum wage at a given level now means labor market effects very different from what it meant in the 1950's and 1960's. We could raise the minimum wage very high indeed if we applied it, say, only to physicians. We could have a very high minimum wage with little adverse employment effect if we applied it selectively only to high-wage groups, which is essentially what was done during the 1950's and before.

Mr. GREENSTEIN. Could I just make one more point? I don't want to get into a debate on the minimum wage, but on the larger inefficiency point. I think I recently read an article in the New York Times that in the New York area—and I think this is true in a number of other areas—employers are increasingly expressing concern that the labor markets are tight, can't find enough employees, that the number of people entering the labor market isn't as large as they would like.

It would seem to me that one of the potential helpful side effects of legislation such as that which you have introduced, is that it might attract more people into the labor market who are not working at a time when we're hearing that a number of employers would like to have more people enter the labor market.

Acting Chairman DOWNEY. Dr. Kosters, I would like to respond to some of your concerns. First of all, I suppose we differ on how

much poverty is acceptable. It seems to me that some of your arguments—and I don't want to prejudge them all because I haven't read your written testimony—would suggest to me that you're perfectly willing to accept the sort of class society that I'm not willing to accept.

Mr. KOSTERS. Excuse me, Mr. Chairman. I don't believe I have said anything about finding poverty acceptable or a class society acceptable.

Acting Chairman DOWNEY. You have claimed that a certain number of people who try businesses and fail shouldn't, for instance, for a year or so, mind being in poverty because that's the price we pay for capitalism. That doesn't appear to be——

Mr. KOSTERS. I would be willing to accept people starting a new business and having a low income for year.

Acting Chairman DOWNEY. I would suspect that of the number of people who we're talking about—that is an infinitesimal number of people—that most of these people are not entrepreneurs who are living on low wages, but rather, people who have never even considered the idea of starting a business. But I don't want to debate that point.

I just want to ask Mr. Ellwood and Mr. Greenstein, a question about being poor, in terms of it being bad, not only for people who are poor, but for the society. If you would address that, because it seems to me that at some point, though we've heard this morning enormous bipartisan support for an expanded earned income tax credit and refundable dependent care credit, that we need to be somewhat more scientific if we can and less anecdotal in our approach to what being poor means to families, to children. If you would elaborate on that, I would find it helpful.

Mr. ELLWOOD. I'm not sure I fully understand your question.

Acting Chairman DOWNEY. Well, is it true, for instance, that being poor is more likely to result in domestic violence, the break-up of families, opportunities for children not to be well-educated?

Mr. ELLWOOD. Sure. I mean, there's simply no question. Again, it stands to reason that one only needs to walk outside and open one's eyes to discover that poverty status is likely to be related to a variety of things and clearly, any time you deal in increased family stress—and families are going to be under a great deal of stress when they're struggling and not being able to make ends meet—you're going to have these kinds of affects.

I should say, it is not clear—just as it's not clear that welfare seems to have created a great deal of families to break-up in the first place, it's also not clear that we can promise that we're going to reverse the dramatic changes in our families with anything like an earned income tax credit. I don't think that's fair.

But I do think it is simply the case, and the evidence is clear and consistent, though not massive, I would say, that when a family is under stress—and low-income is a very, very serious form of stress—that a variety of negative outcomes are much more likely to occur and there's simply no question about that.

Again, in the end though, it seems to me, that the call for doing something about the poor is really a personal one. It's a matter of right and wrong what you believe, but again, I know I've talked to a variety of groups, as you do. I visit welfare commissioners, those

on welfare and so on. I don't think I found anyone who wants to stand up for the principle that if you work, it's okay to be poor in America. It seems to me that's the bottom line

Mr. GREENSTEIN. I would simply add, as I think members of the subcommittee well know, that due to changing demographics, we increasingly have a need for a much larger proportion of children to grow up to be productive workers than we might have had in the past in the 1970's, between the combination of the baby boom, a lot of women entering the labor market. There were more people looking for jobs and there were jobs to go around.

Now the number of new entrants entering the labor market each year has gone down. The Labor Department former Secretary Brock, former Secretary McLaughlin, have been talking about this for a number of years, what the work force is going to look like in the year 2000.

If you put these two pieces together, we have a greater need for each child to be a productive worker. And also, that the proportion of the work force of the future that is going to consist of people who are today children in the low-income, minority, and disadvantaged families—you put those two factors together, it really creates a considerable degree of concern.

Again, it's often said that there are going to be far fewer workers supporting each Social Security recipient off in the future than has been the case in the past. So, I think this is why we see a growing number of business groups talking about more investment in children and families with children. And here, as David Ellwood and others have said, this is an area that shouldn't be too controversial.

We have a lot of fractious debate over issues relating to welfare. We shouldn't have debate over this principle, that if the parent works, the family and the children shouldn't have to live in poverty.

Acting Chairman DOWNEY. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Ellwood, as you know, the cost estimate for this legislation is $24 billion, which is 25 percent higher than what we now spend for JTPA. I just wondered what your thoughts are, whether or not it is advisable to be subsidizing wages as opposed to having more training and job placement?

Mr. ELLWOOD. That's an excellent question. I don't see these as necessarily replacing one another, but the reality is, we've done quite a lot of extensive testing on job training and other kinds of programs. In general, the average impacts are modest. The benefits tend to exceed the costs, especially if the programs are well-designed and so on.

The reality is that even if we double the Job Training Partnership Act, we'll still have an enormous number of families still working and still poor. And if we tried to serve all those families that are currently in this situation, number one, we'd take them out of the labor force while we're doing it, which might be counterproductive.

Number 2, it would be very, very expensive. I think the beauty of this bill is it goes right to the people that are poor and near poor, that are already working, already in a job, and says, listen, we're not telling you to get out of your job. We're telling you, we're going

to make it worth your while. We're going to pay you to do it and in a way that's done through the Tax Code, which is a relatively modest change in terms of law. It is a substantial amount of money.

However, it is substantial in one sense. It is, on the other hand, even this bill is revenue-neutral. There's a sense that what this is doing is taking money and rewarding work. It's very different from money that might have been spent in some other fashion. So, I think this money is exactly where it should be and I would advocate keeping the whole EITC rather than taking say part of this away and expanding JTPA.

Again, that's not to say there aren't a lot of advantages there, but I think this money is as well spent as any money you'll get a chance to vote on.

Mr. GREENSTEIN. I would just add—and I'm not saying there may not be a need for more resources in JTPA—but in training programs in general, I would think that part of what we need to do is to reorient them somewhat to place a greater emphasis on basic skills and there are places within summer jobs, vocational education, JTPA, in which we can make improvements that in and of themselves don't necessarily require a lot of new researches.

That's not to say there may not be a need for some resources as well, but I would end up where David Ellwood does, that I would not siphon off some of the funds in this bill to go to the JTPA side.

Mr. COYNE. Dr. Kosters, to what extent do you think a case could be made, if one could be made at all, for the fact that our need to be internationally competitive and the urge to ratchet down wages over the past several years has allowed many people to fall into the working poor category?

Mr. KOSTERS. I guess I don't think it's very easy to make the case for that, quite frankly. Our need to be competitive abroad relates to individual industry wages and so on, but it also relates to the exchange rate. The foreign exchange value of the dollar is free to adjust and has adjusted, in fact, a great deal in both directions during the 1980's.

So, it seems to me that certainly competitiveness with countries abroad is a factor, but the main issue is really the question of just what level of real output and production of goods and services our work force can achieve. It is the overall productivity of the work force that seems to me to be of fundamental importance. International trade patterns, by-and-large, will simply raise the achievable level of consumption that we can sustain above the level set by our own production.

I don't think we should look at trade as if it were an instrument that lowers either our wages or our living standards. Trade, instead, tends to enhance them.

Mr. COYNE. So the concessions that the steel workers made and other workers throughout the country over the past several years has had no effect relative to creating a larger segment of our society that can be categorized as the working poor?

Mr. KOSTERS. I don't think wage concessions really had any such effects. That is, steel workers, even after their wage concessions, usually don't earn low wages. What probably did have a significant effect, however, is that in certain communities many steel workers

lost their jobs. Job losses put some into poverty and put most into jobs that paid lower wages.

We should recognize, of course, that during the 1970's, the relative wages of steel workers and auto workers and some in other industries increased a great deal. Their wages were very significantly out of line with earlier experiences. And certainly trade competition was a factor in reducing those relative wages. More competition has been a factor in other industries that have been deregulated over the years. There have been wage adjustments in those areas and in other areas as well.

Mr. COYNE. But in your testimony, you made the case that to the extent that wages have increased, that has brought up the lower segments, the lower paying jobs, and the point I'm trying to make is that to the extent that steel workers and others, not just steel workers, but other people in the manufacturing sector, have had their wages kept down, that has filtered down into the lower paying jobs and created a larger segment of the working poor.

Mr. KOSTERS. You make a very interesting point. There's a great deal to what you say. In individual circumstances and in individual communities, what you have suggested has surely happened. There is no question about that. In addition, it's also true that the real wages that a person can earn at the minimum wage level are lower now than before, and there are more people working at wages in that range.

Now, the interesting thing is that in spite of these phenomena during the 1980's and sometimes before, there has not been an increase in the overall share of the work force working at low-wage jobs. That is, there have been a variety of offsetting changes—moves in the other direction—that have tended to keep the shape of the distribution quite stable over the years.

And that's really the basis for my judgment—that the key to reducing poverty is going be to increase productivity, and to get the distribution moving upward again like it did during the 1950's and 1960's.

Mr. COYNE. Thank you very much.

Acting Chairman DOWNEY. Mrs. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman.

Mr. Greenstein, you mentioned, almost as an aside, not to make the tax return more complicated, that if it's more complicated then we lose people from applying in the area of tax benefits. One of the things that everybody agreed on about the 1986 Tax Reform Act is that we would continue to have our problem with the underground economy—people earning and not reporting—and then, of course, we have the seasonal workers who sometimes work and then are unemployed.

Maybe we are on to something. Do you think since we are taking this whole thing up, maybe we should do something even more dramatic to look at this whole picture a little more? What I am afraid of is sometimes when we have a deficit, and we do not have anybody to work on it; we are reaching all the time for legislation. I just wonder are we really hitting any of these people with this earned income tax credit. We have all these other things going on on the side. Is there anything you think we can do more dramati-

cally to reach more of these people? You mentioned a figure of 15 percent.

Mr. GREENSTEIN. Well, I think what I was saying was that about 10 to 15 percent of the people who get the earned income credit are people who file a tax return and do not fill out anything on the form in relation to the credit. But the IRS goes over the form and finds that they are eligible. They compute the credit for them and send them a check. We have to make sure that that continues.

I am not sure. I mean, I guess I would see the bills that are before the subcommittee—in particular, the chairman's bill—as being very significant and pretty dramatic. And I have some hope, and there is obviously some disagreement on the panel on this. But I have some hope, given in part the President's statements during the campaign, that during this year we may get a minimum wage increase as well.

I think the combination of the two, a bill such as the chairman's and a minimum wage increase, could have a significant impact.

It is very difficult to predict whether, and if so to what degree, these kinds of measures would draw more people into the labor force or draw more people out of the underground economy.

Mrs. KENNELLY. That is what I am trying to get at.

Mr. GREENSTEIN. Certainly, somebody who is making a couple thousand dollars a week selling drugs is not going to be affected by a bill like this. But I suspect that for every person who is making several thousand dollars a week selling drugs, there are likely a number of people who are engaged in more minor endeavors in the underground economy, more minor hustling, making much less money from it. And maybe, hopefully, for some of them—as you reward the gains from legitimate and gainful employment; you hopefully would—you ought to be drawing more of them into the mainstream economy. I do not think we can predict with certainty that that would occur, the extent to which it would occur, but I think it is reasonable to believe that it would occur to some extent. And that would certainly be helpful.

I would add, given that I know your long interest in the situation of single-parent families, something we have just found in the last day that we are now looking into that is of concern to me is IRS apparently has just changed a policy with regard to computing the earned income credit for working single-parent families who file a tax return. It turns out that some single-parent families check the filing box "single." They say: I am single; I am not married. They do not know what head-of-household means. So they check "single."

If they then also claim child dependents and they have earnings in the right range, IRS used to compute the earned income credit for them because they were eligible, if they did not check it and send them a check. IRS has now changed their policy, and they will no longer compute the credit for those people. It is tied in with the changes, the positive changes that I think you were one of the principal authors of raising the standard deduction for the single-parent head-of-household.

I just learned of this yesterday. I am very concerned that this may cause a number of single-parent working families who used to get the earned income credit to lose it, starting this year. It is

something we might be interested in talking with you further about in the next weeks or so as we learned more about it.

Mrs. KENNELLY. Thank you for pointing that out. I would like to follow up on that. We should find out if it is a policy and the particular reason for that policy.

Mr. GREENSTEIN. We have confirmed yesterday it is a new policy just instituted by the IRS.

There are some technical tax reasons for doing it, but the effects are going to be unfortunate. We are still looking at the technical issues behind it. I cannot speak to them yet, but we have confirmed that this change has been made.

Mrs. KENNELLY. All right. Thank you very much for pointing that out.

Mr. Ellwood, just to continue this a little bit, in the section that we read from your book, you referred mainly to two-parent families who were working and were in this situation. What kind of jobs did they have? I guess my question is once again: Are you looking at the mainstream worker? Is that the person you are looking at in the retail field working behind a counter, and do you look at other segments, such as seasonal workers or others? What kind of work do your people have?

Mr. ELLWOOD. Well, the answer is it is a really wide, very diverse range of work, and that is sort of the point. Some of it is retail and a certain amount of light manufacturing; services are heavily represented. There is a certain number of the self-employed, more of the form seen in the rural area where you cut lumber and you sell that as your, you know—seasonal work of that sort. So I do not think we know in detail who all those people are.

Let me respond to the question you also asked Bob Greenstein. I think this is so much more significant than anything you have contemplated during the last ten years that you really want to take it very seriously. I mean, this is going to move lots of people out of poverty or closer to out of poverty. This reinforces work; this reinforces family; this will help single parents; it will help two parents—all by encouraging work. And the amount of money we are talking about here, the effectiveness of it—you know, this bill seems to me, as far as I can tell, mostly controversial because it costs money. Imagine a welfare bill that was more controversial mostly because of the money. I mean, so many of the other issues that we have to fight with day after day—there is a changed family structure—this is all in the right direction.

I do not think you need even make any claims that it is going to bring more people in the labor market or strengthen families, although I think those claims can be made with justification. It is going to help an awful lot of families that are right now, as I said, playing by the rules and losing the game to be somewhat better off. So I think this is a very, very significant piece of legislation.

I would also like to reiterate, if you do not do something like this—you know, you can deal with welfare reform until you are blue in the face. It is what I do for a living, after all. And so I am encouraged that you continue to deal with it since I will continue to earn a living. But the reality is, if work does not pay, you are never going to solve it. It just cannot happen. It is as simple as that.

You look at the green book. You look at who the poor are. The section you read, it sounds like, was on the two-parent problem. In another chapter on the single-parent poor, I go through that, plus the nature of the welfare system, looking at how this affects them as well. This is not all that we need to do, but it is a very important step. Without it, I just do not see how we get from here to there. With it, I can see how we get from here to there.

Mrs. KENNELLY. Really, both things are my concerns; that if we do this, we bring people into the mainstream, out of those shady areas that we cannot count.

Mr. ELLWOOD. Yes. But, also, the way in which I really do agree with Dr. Kosters is that these people do ride most of the same trends as the mainstream. This is the people at the bottom of the—they are on the same roller coaster. The problem is, you know, they are just getting a much scarier ride than the rest of us are. We, by ignoring them—it is not that they are not part of the mainstream. They are the mainstream.

There is the Bower Report out of the Reagan White House called "The Value Rich But Money Poor." That is who these folks are. But it seems kind of crazy to be not rewarding the value rich and money poor.

Mrs. KENNELLY. If I can go on, thank you.

You know what I mean. I just do not want to see us looking at one group and forgetting that other one.

Mr. ELLWOOD. Yes, but this is the group that has been forgotten. This is the group that America just does not even believe exists, even though it is much larger than the so-called "ghetto underclass."

Mrs. KENNELLY. Thank you.

Mr. GREENSTEIN. The number of people who we would affect through this legislation is vastly larger than the number impacted by last year's welfare reform bill. I think I would speak for both David and myself in saying that we would believe that the impact in reducing families of children from poverty of this bill would be many times the impact in that area you will get from last year's welfare reform legislation.

Mrs. KENNELLY. Let me tell you, that is what I have been picking up this morning. Let me take it a step further. Should we have done this first?

Mr. GREENSTEIN. You can argue about which one you should have done first. Some of us at one point last year were talking about putting the two together. I know I had some conversations with Senator Moynihan; at one point, he did have a draft of something like this in his bill at one point and then removed it because it made the total cost of the welfare reform bill large, and there were limits to what could be paid for in last year's package.

But without really getting into the debate of which one one should have done first, one of the underlying themes of welfare reform was to move people from welfare into work. The idea is not simply to make the welfare poor into the working poor, but to really make them self-sufficient and able to stand on their own feet and not be poor. Secondly, really, you know, there is only so much you can do through the welfare system, even for welfare recipients. The concept of how much work will pay and what the conditions

for themselves and their children will be like if they work, clearly is going to have an impact on their decision.

You know, one year of child care and health care coverage after you leave welfare is nice. What do you do after that? What is your wage level? Do you get any refundable day care costs? Any credit for your day care costs right now you do not because the child care credit is not refundable.

In the long run, I would not be surprised if this has a significant impact on the welfare group who are trying to move into work. It is consistent with welfare reform. It reinforces what you were trying to do in welfare reform, as well as helping the much larger group of people in working poor families, which is significantly larger than the number of people in welfare families.

Mrs. KENNELLY. Just one more question. So what I think I am hearing is, "forget what we did first." That is the past. But if you want welfare reform to work, you had better do this piece to keep the working poor off the rolls.

Mr. ELLWOOD. Absolutely. Just two examples. In California and Massachusetts, for both the following is true. They have found that when they place someone into a job, if the job does not pay about $6 an hour and have medical benefits, those people will be very quickly back on welfare. Well, the notion, with the minimum wage at $3.35, that we are going to take people, many of whom are high school dropouts, young children, finding a job for a year full-time paying $6 an hour, to me it is ludicrous. It is not going to happen.

As a result, what you find is that the people that gain from those programs are often the people that, yes, they have the good educations, they are ready to go, they can make the difference. But they are not the long-term folks. They are not the people you are spending your money on. So I think they are complements. Whether one should come first over the another, I do not know. But without this, welfare reform will not have very much of an impact. This will improve the chances of welfare reform really making a difference.

Mrs. KENNELLY. Thank you, Mr. Chairman, very much.

Acting Chairman DOWNEY. Mr. Matsui.

Mr. MATSUI. Thank you very much, Mr. Chairman. I have a statement I would like included in the record.

[The statement follows:]

Statement of
THE HONORABLE ROBERT T. MATSUI
THIRD DISTRICT OF CALIFORNIA
before
THE HUMAN RESOURCES SUBCOMMITTEE
WAYS AND MEANS COMMITTEE
on
HELPING THE WORKING POOR
February 28, 1989

Chairman Downey, I want to thank you for holding this very important hearing on the need to help the working poor of our nation. I also want to express my support for your bill, "The Employment Incentives Act", which expands the earned income tax credit, makes the dependent care tax credit refundable, and increases the Title XX entitlement to ensure that States have sufficient resources for assisting the poorest of working families with especially high child care expenses.

Although the White House has proudly stated that our nation has been on the road to economic recovery, that road has been blocked for many poor Americans. Our most recent census data shows that the national poverty rate is almost 14 percent --- higher than it was even during the recession years of 1974 and 1975. We are currently faced with some 32.5 million Americans trying to survive on incomes below the poverty line. In 1987, one of every three black Americans were poor, and even more shocking, nearly one of every two young black children lived in poverty.

Last year Congress passed the Family Support Act of 1988. This welfare reform bill reflected the bipartisan commitment to productive work as an alternative to welfare dependency. We all agreed that gainful employment should lessen the drain on limited public resources and provide the individual with a sense of dignity and hope. We emphasized work training in the Family Support Act and to a great extent perceived work placement as the route to escape poverty. We endorsed, if indirectly, the myth that the motivated and industrious among the poor can lift themselves out of poverty through hard work.

In fact, the statistics on poor in this country quickly negates this myth. Almost five and a half million people in this country work yet still live in poverty. Almost 20 million poor adults and children live in the households of these working poor. They are paid wages which are simply too meager to pull them out of poverty. It is also a myth that the industrious will find themselves upwardly mobile and that the problem of the working poor is only a temporary one or a fate of the lazy. The reality in this country is that working poor frequently hold unskilled jobs working long, hard hours. They are unlikely to acquire the skills at their jobs or with their limited free time and spare money to move into higher paying employment.

Work and poverty are not mutually exclusive. We may help welfare recipients to move off the welfare roles and into working status, but we do not necessarily move them out of poverty. A federal policy which then abandons those who do work is seriously flawed. If the disposable income of a nonworking AFDC family is greater than the same family's income if the parent works, something is wrong. Congress cannot turn its back on the working poor. Our nation has a labor force working hard performing tasks essential to our society, and they cannot provide for the basic needs of their families.

A recent survey of poor people conducted by the Coalition on Human Needs revealed that many poor women with children simply cannot afford to go to work and loose Medicaid health care coverage and pay for child care. The work transition provisions of the Family Support Act, although providing some help, really do not solve the problem. If we confront the fact of limited upward mobility for the majority of poor workers, the solution goes beyond a limited work transition period. This Committee must explore how to provide assistance to the deserving working poor that reaches past some arbitrarily designated transition period from welfare and addresses the continuous needs of this population. If work does not reward, where will the next generation turn for survival? Street crime? Drugs?

The Employment Incentives Act would reward work and industriousness by providing a subsidy to the wages of the working poor (via an increase in the earned income tax credit). It also reduces the cost of working for poor families by making the dependent care credit refundable and increasing Title XX Social Services Block Grant funds targeted for child care services. Chairman Downey, I am very pleased to co-sponsor this bill. It will make our federal system of aid to needy families more equitable and make work a more attractive option for the next generation.

Mr. MATSUI. First of all, I would like to really commend you for your introduction of this legislation. I think it is excellent and certainly well overdue. I certainly will support it.

I would like to ask both Mr. Ellwood and Mr. Greenstein a question. I do want to apologize; we had another hearing in one of our subcommittees, and I was not able to arrive during the course of your testimony.

Following up on what Representative Kennelly has indicated, assuming we had a choice—and I think politically we probably do not have a choice. Does it make more sense to use the proceeds from the tax bubble to expand the earned income credit and the refundable child care credit? Or does it make more sense, if it were politically possible, to put the money into AFDC benefit increases by giving States the incentives to increase their benefit levels, something similar to what we had in the House bill before it went into conference where it was stripped out?

Perhaps Mr. Greenstein and Mr. Ellwood could comment.

Mr. GREENSTEIN. Two thoughts. First, you had a key qualifier on your question. You said "assuming it was politically possible."

Mr. MATSUI. And I do not know if it is, because not many PAC's represent welfare recipients.

Mr. GREENSTEIN. But the first part of my answer would be that I think it is not politically possible. You would be talking about moving a very large amount of money into the welfare system. Beyond that, either you mandated those increases or, as you did last year, you provided incentives. And if you provided incentives, you always have some leakage. Some of it would have occurred anyway, et cetera, et cetera.

As you know, I liked that provision in last year's bill and thought it was——

Mr. MATSUI. Incidentally, I want everyone to know—and I know everyone knows this—Mr. Downey was a great supporter of that provision. We just had a problem with the Senate side, unfortunately. I call that to everyone's attention.

Mr. GREENSTEIN. You know, I do not think it would be likely to be a real choice. In fact, I think what is fascinating is that if you go back through history, the first testimony that we can find bringing the concept of the earned income tax credit to Congress was in the early 1970's during debate on welfare reform, from an ardent opponent of welfare reform who was then the governor of California, Ronald Reagan, who came to the Finance Committee and said: What you ought to do instead of the Nixon administration's welfare reform plan is—and he outlined something that essentially is the concept of the earned income tax credit. It has remarkably broad support across the political spectrum.

In addition, there is the point that David Ellwood keeps making that we have a fundamental issue here that we say we want people to work, and they work and then they are well below the poverty line. This kind of does build, in part, on Congresswoman Kennelly's question.

I do think the appropriate next step at this point is in the earned income credit area, is in the nature of what is in the chairman's bill. You know, I do not know when in the foreseeable future—this century or maybe in my lifetime—we will get changes of that

nature in AFDC benefits. But we certainly can do something about families that work and are poor and have children. And I think we ought to do that.

Mr. ELLWOOD. I think my answer would pretty much be the same. Politically, the notion of spending this kind of money on welfare reform of any sort, it seems to me, is you are a better judge than I.

Mr. MATSUI. No, I am not.

Mr. ELLWOOD. But my sense is that this will never happen. This is a way of reinforcing all the values that welfare creates conflict with. Okay? And when you raise welfare benefits, again, you do discourage work to some degree. You do create the impression of subsidizing single-parent families. You do tend to isolate people because they are on welfare, and the society deems them differently.

I think a lot of the problems are I think welfare is mistreated and misunderstood. Nevertheless, that is the reality. This reinforces work. This reinforces family. This reinforces bringing people into the mainstream. This does all of those things for a group of people that has been largely ignored, for a group of people that you put them on the nightly news or you put them on the cover of a U.S. News & World Report, and people send checks in the mail. Okay?

Now, I also believe this is very much the right way to go. I think over the long term we are going to have to find replacements to the welfare system, non-welfare supports such as these which reinforce and encourage the kinds of things we want to do, while at the same time providing some sort of security.

I think with this we can move a giant step closer towards making welfare transitional, which seems to be the real goal now of those on all sides. Without this, I think we are never going to get there.

Mr. MATSUI. I think, Bob, you wanted to follow up.

Mr. GREENSTEIN. If I could just add, I certainly think—and I know all the members present of the subcommittee share the view—that AFDC benefit levels, especially in certain parts of the country, certain States, are unacceptable.

Having said that, however, for families that work, if they can be brought to the poverty line without having to go on welfare, that seems to me to be a very desirable goal. Nobody likes welfare. The recipients do not like; the public does not like it. It is often stigmatizing and isolating and demeaning to have to go on it.

Through coordinated policies—in my view, a bill like the chairman's and a minimum wage increase—you can get families with a full-time worker to the poverty line without them having to go on welfare. And wherever you can do that, through that approach rather than through a welfare approach, I think that is desirable. For those who do not work, who cannot work, who are out of work, who have young children, in the long run we need to find ways to deal with welfare benefit levels. But I think that is in no way a conflict with this. And we learned last year that it may be a long time, if ever, until we can address that other issue.

Mr. MATSUI. I appreciate your comments. I am really taken by your pessimism in terms of AFDC benefit increases, but I may share that pessimism now, frankly, after what we went through

last year. As I indicated, I think the House did quite well. It was just the problems that we had in the conference with the Senate. And, of course, with the administration.

Mr. GREENSTEIN. Maybe if we had a President who made that a priority, it would be different. But that may take a while to happen.

Mr. MATSUI. I guess we should just take what we can get at this time.

I would like to ask Dr. Kosters one or two questions. I would like to follow up on the first question that Mr. Downey asked you, Doctor.

You indicated that by having the refundable credit, we could make the system more economically inefficient. And on Page 8, the second paragraph, you describe how that could occur, where members of a small group arrange to share child care among others in a pattern coordinated with their part-year or part-time work. And you mentioned that in your answer to Mr. Downey.

My concern is, I only thought defense contractors were capable of coming up with this kind of tax avoidance scheme. How would low-income wage earners really come up with this? They are not capable of going out and hiring tax lawyers to come up with this kind of plan. Your argument is somewhat disingenuous, I would say.

Mr. KOSTERS. Well, first of all, I agree that these people have a difficult time affording a tax lawyer or tax accountant is that is an important point to keep in mind when it comes to introducing too much complexity into these schemes. Indeed, I guess I would ask myself whether the welfare program, as we know it, my not be preferable to many of these people in that regard, since the caseworker does the paperwork and supplies the services for which a tax accountant would otherwise be required. So I think that is important to keep in mind.

The important point of my example is not that kind of arrangement per se. After all, you could easily put some requirements in the legislation that would preclude it. But that would only make the waste less obvious; it would not eliminate the waste. To the extent that there is an incentive effect, people would be inclined to develop tax-avoidance schemes.

I am not entirely clear on what the main purpose of this kind of proposal is. Some have suggested it is to encourage work. Others have suggested it is mainly to help members of working poor families.

It seems to me that it really is important to ask ourselves: What do we know about the extent to which it is likely to encourage work? What have we learned from the negative income tax experiments?

Mr. MATSUI. Well, you know, proposals are made a lot of times without knowing precisely the goal. For example, the President's capital gains proposal, I do not think anybody—including the President—knows what his goal is except to fulfill a campaign promise. But to me it seems like both of the rationales make some sense: one, to encourage work; and, secondly, to help those that are low income try to achieve, as both Mr. Ellwood and Mr. Greenstein

have suggested, a standard of living at least closer to middle class or a little above the poverty line.

Mr. KOSTERS. When I ask a question of this kind. I do not claim to know the answer. The question I ask is: Given your experience last year with the welfare reform legislation, are you persuaded that the Tax Code is a better way to distribute funds than through the welfare system? It may be, but it seems to me that is really the kind of case that needs to be made for wage subsidy programs.

Mr. MATSUI. Would you be willing to go before, let us say, Education and Labor and maybe our committee some other time and suggest a tax increase or benefit level increase through direct appropriations?

Mr. KOSTERS. Tax or benefit increase for what?

Mr. MATSUI. For direct appropriations. In other words you are suggesting the Tax Code is an inefficient approach, and perhaps it is. But who in the administration, and are you going to suggest that we actually spend money and then tax people in order to pay for that spending program?

Mr. KOSTERS. Well, I may be willing to suggest that. After all, I did suggest in my testimony——

Mr. MATSUI. We cannot have it both ways. We cannot say one thing and another thing in another committee or subcommittee.

Mr. KOSTERS. Well, I did suggest in my testimony that we extend the earned income tax credit to people who are poor, irrespective of whether they have dependents, because they are part of the working poor too. I also suggested that if we want to do more for families with children, it would be a good idea, in my judgment, to introduce some kind of dependent tax credit, but one based on the number of dependents, but not a dependent care tax credit.

Mr. MATSUI. If I can move to Page 9, in the first full paragraph right in the middle, it says, "A more important consideration is that special tax treatment for child care expenses in low-income families encourages commercial arrangements for child care when informal arrangements or parental care at home may be preferable for the family and for society as well."

I have heard that argument expressed before, but can you elaborate on that a little bit more? You are suggesting that it might be better to allow the status quo rather than set up commercial arrangements where you can have regulations and perhaps a more conducive atmosphere for the child?

Mr. KOSTERS. Well, I guess my first point would be that parents can be expected to care more about their children than anybody. Consequently, it seems to me that we should not be reluctant to support families where the mother does stay home to take care of children. I regard such activity as an investment in the future.

Now, with regard to commercial arrangements, there are two points in my judgment. One is that there are apparently many poor families who do not now pay for child care commercially, but they do have some sort of child care arrangements. There may be exchanges within the family or whatever. So it seems to me that a program should try to help people in that kind of situation. Point one.

The second point is that I see no reason why we should artificially encourage commercial arrangements, along with the paperwork

requirements of making sure you keep the bills to submit them as evidence that you are eligible for the dependent care credit and so on. I would prefer more simplification in that regard, more discretion for choice by parents, and more neutral treatment among child care arrangements.

Mr. MATSUI. Would you extend that same principle—I guess you would—in terms of custodial nursing home care as well? You know, there are a lot of people right now that handle that within the family. For that reason, you would not want to see us as a Government get involved in long-term nursing care because you would see an expansion of commercial arrangements?

Mr. KOSTERS. Well, it seems to me there are two separate issues there. One is what is neutral with regard to commercial arrangements versus informal arrangements. And the other question is: Should the Government help people who need nursing home care? I think that on the second question, it is appropriate for the Government to provide help for nursing home care under some circumstances, like it is appropriate to provide income support for poor families. On the first point, yes, I would prefer the Government to provide help in a more neutral way than it now does, also for nursing home care.

Mr. MATSUI. Thank you very much.

Mr. ELLWOOD. May I just make one quick response?

Dr. Kosters, people have used the results of the negative income tax experiment to look at the impact of things of this sort. Notice the incentives are quite the opposite of a negative income tax. A negative income tax, the more you work, the less you get. Here, the more you work, the more you get, up to a limit for low-income workers.

So, in fact, the work effects of this versus, say, a negative income tax or other welfare mechanisms are vastly smaller. A negative income tax suggests, you know, you give people money, you do reduce work somewhat. This does not reduce work. So it is really very different from the guaranteed income.

And I almost hear you saying maybe it would be more efficient to put all these people on welfare than encouraging them to work. That I struggle with a great deal, not only for efficiency questions, but also just, it seems to me, that anyone that has been on welfare or spent time on it and so forth knows the sort of frustration and stigmatization, to say nothing of the high marginal tax rates that are built into those things. This is the reverse of that. It has a negative marginal tax rate.

Mr. KOSTERS. Well, I am not entirely persuaded by your point on the negative income tax. It just seems to me that this proposal is, in fact, a species of negative income tax. That does not make it necessarily bad or good, in my judgment. I really genuinely ask the question whether this is a better way to distribute income to poor families than the welfare system or not.

It seems to me that it is more appropriate to ask this question than to try to make the case for this proposal by using a lot of numbers, such as for example, the numbers that Mr. Greenstein so ably presented. Those numbers, after all, are presumably out of date, given the tax changes already in place. That is, the new earned income tax credit enacted in 1976 is not at all reflected in

those numbers. So those numbers really are not very relevant for the present and future, it seems to me.

Acting Chairman DOWNEY. Census Bureau numbers.

Mr. KOSTERS. Yes, that's right. That is, those Census Bureau numbers are for 1986, possibly some for 1987, I take it. No 1988 numbers are available, which is the first year that the Tax Reform Act takes full effect. Moreover, its effects would not even be reflected, in the first instance, in those numbers because an analysis of the effects of benefit and tax changes would first be necessary.

So, it will be a period of a couple years before we really know what the effects of current Tax Code provisions have been.

Mr. GREENSTEIN. There would be some effect, but I would be very surprised if it was that large. Because to properly reflect all those changes in the poverty data, you would not only have to count the earned income credit—you would have a change in Federal income tax—but you would also have to count, which the current poverty figures do not do, the Social Security payroll tax that people pay; you would have to count the State income tax that people pay.

I do not think there is any question that the net effect of the Tax Reform Act of 1986, if you count taxes as income, that it clearly would have reduced poverty somewhat. But I think we would still find a significant overall increase since the late 1970's in the number of people who were poor.

Mr. KOSTERS. I think it would be very interesting, given those comments, to do a comparative analysis and ask what effects do we expect the 1986 changes to have—using 1986 or 1987 data—and what might we expect from the current proposals, and then compare those two effects that one might expect. It seems to me inconsistent to think that there would be big favorable effects from this proposal, merit though it may have, but very little effect from the Tax Code changes in the 1986 act.

Mr. GREENSTEIN. Let me clarify. I think the effects were probably quite significant from the 1986 Act if you are comparing 1988 to 1985 or 1986 before they took effect.

On the other hand, what the low-income provisions of the 1986 Tax Reform Act did was they took total income and payroll tax burdens for a family at the poverty line; after factoring in the earned income credit, they simply returned those overall burdens to about the same level as 1978.

So if you are comparing the effects of the tax changes to the late 1970's, it is not going to have a big effect. Therefore, it should not have a big effect on the numbers I cited in my testimony.

To be sure, if you want to do a before and after, 1985, 1986, right before the tax reform bill, 1987, 1988 after, I would suspect that it would have a large effect. But I do not think that is as relevant to the longer-term comparison I was trying to make.

Acting Chairman DOWNEY. This debate is over. Thank you for being here. The subcommittee is adjourned.

[Whereupon, at 1:25 p.m., the subcommittee was adjourned.]

PROBLEMS OF THE WORKING POOR

TUESDAY, MARCH 21, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Thomas J. Downey (acting chairman of the subcommittee) presiding.

Acting Chairman DOWNEY. The subcommittee will come to order.

Today the Committee on Ways and Means will release its annual committee print known as the Green Book. In it, you will find some pretty discouraging facts about the growing plight of working poor families. For example, between 1973 and 1987, the average income of families with children increased 13 percent, adjusting for both inflation and family size; but over the same period, the average income of the poorest 20 percent of families with children fell 22 percent. Even if one takes into account changes in taxes, food, and housing benefits, those results are troubling.

As incomes have declined for those at the bottom, more and more working families have been thrust into poverty. Census Bureau data in the Green Book show that the number of working poor families with children increased 30 percent between 1979 and 1987, even among those families with significant work. In 1987, over 6 million Americans lived in poor families in which at least one person worked close to full time, a full year.

Now you have to think beyond these numbers, of course. Behind each one of them lies an American family struggling to join the economic mainstream, struggling to share the American dream, a dream which they build for others but haven't been able to realize for themselves.

The problems of the working poor should be a national priority.

It is my hope that through hearings like this one, we can highlight the struggle of the working poor and begin to develop a consensus for policy approaches.

I welcome the opportunity to hear testimony today from two panels of public witnesses. On the first panel are Dr. Isabel Sawhill, a senior fellow at The Urban Institute; soon to join us, I hope, Marian Wright Edelman, president of the Children's Defense Fund; and Gary Bauer, president of the Family Research Council. Later this morning we will be hearing from a second panel comprised of representatives of the United Church of Christ, the Office for Church in Society; the Kelso Institute; and Child Care, Inc.

Dr. Sawhill, Mr. Bauer, welcome. Dr. Sawhill, if you would begin.

STATEMENT OF ISABEL V. SAWHILL, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE

Ms. SAWHILL. Thank you, Mr. Chairman. I am delighted to have the opportunity to testify today. I want to commend this committee for its focus on the working poor. A number of us have been working on this issue for some time, and have come to the conclusion that it is a critical issue for the Nation at this time.

I think previous witnesses at your earlier series of hearings laid out extremely well the nature and magnitude of the problem, and much of the material that I have seen coming from your staff has done the same. In my written testimony we have provided additional data on the size and characteristics of working poor households that will supplement those earlier efforts.

Overall there are 6 million households who were poor in 1986, despite the work effort of the head. I am particularly struck, however, by the fact that about 1 million of those households have children and are headed by someone who works full time for the entire year. Of this last group, about one-quarter are headed by women and about three-quarters by men. No one can argue that this last group isn't doing everything that they can to support themselves, yet we also know that many of them, especially those with female heads, would be better off if they were on welfare.

I think your proposal, the Employment Incentives Act, is a commendable response to the problem. I have no major criticisms of it. I wish it could be more generous, but I understand that in the current fiscal environment that may not be possible.

As currently structured, we estimate that it will assist about one-fifth of all poor households. I wouldn't want to argue that it should be extended necessarily to other households, particularly households without children. However, I think it might be worth at least thinking about making absent fathers who are paying child support, and thus trying to support their families, eligible for the earned income tax credit.

Coverage, however, is not it seems to me a major issue; adequacy is. The proposed Earned Income Tax Credit will clearly help the working poor, but it will not move a family where the head is working full-time at a minimum wage job above the poverty line. Thus, I would like to see a somewhat more generous credit.

I realize that a more generous credit is either going to be extremely costly in budgetary terms or it is going to require that we subject these families to extremely high marginal tax rates as they phase out of the program at higher income levels, or some of both. But, since I have never been persuaded that high marginal tax rates have major effects on work effort, I personally would be willing to accept a higher tax rate in return for a slightly more generous program.

The other way to go, of course, is to assume that there is going to be an increase in the minimum wage to at least $4.25 an hour and probably a little higher. That, I think, would go a long way towards solving the problem.

I completely support the notion of making the Dependent Care Tax Credit refundable. Work that we have done at The Urban Institute has shown how highly regressive the current Child Care

Tax Credit is. You are going to hear arguments to the effect that this biases a mother's decision about whether to work or to stay at home in a two-parent family, in favor of going to work.

I would like to say that I think this is a very misleading argument because it does not take into account the fact that two families who have exactly the same earned income, but one of which has extensive child care expenses and the other of which doesn't, don't have the same taxpaying capability, any more than two small businesses in which one has more costs of earning their profits than the other have equal taxpaying capacity, and I think our policies should clearly reflect that.

I do, on the other hand, worry about how many low income parents are going to be able to claim this credit. My understanding is that, as a result of the Family Support Act, we now insist that to be eligible for this credit, you must report to the IRS the Taxpayer ID Number of your child care provider. The population that we are talking about depends heavily on informal arrangements, and it may be that many of the people providing child care for them will not be able to produce an ID number that their parents can use to claim the credit, so I would urge you to at least look at that issue a little more.

Let me conclude by once again congratulating the committee for its focus on the working poor and for what seems to me like a sound proposal for dealing with the problem. Thank you. I would be glad to answer any questions.

[The statement of Ms. Isabel Sawhill follows:]

ASSISTING THE WORKING POOR

Statement before Subcommittee on Human Resources,
Committee on Ways and Means

on

March 21, 1989

ISABEL V. SAWHILL*

The author wishes to thank Susan Hendrickson and Bret Birdsong for their assistance in preparing this testimony.

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Any opinions expressed herein are solely the author's and should not be attributed to The Urban Institute or its officers or funders.

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ASSISTING THE WORKING POOR

I support the Employment Incentives Act and commend the Committee for its focus on the working poor. I want to note that I first became interested in this issue when I was working with The American Agenda, a bipartisan group, cochaired by Presidents Carter and Ford, that was organized in 1988 to provide advice to the incoming President. The American Agenda felt that this was one of the critical domestic issues warranting a new President's attention.[1] It is also an issue to which we have devoted considerable attention at The Urban Institute.[2]

The problem is that, despite most Americans' belief in the work ethic, in today's economy working does not always pay. Earnings in a minimum wage job are not enough to move most families out of poverty. In 1987, a full-time minimum wage job produced an income of $6,968. At these wages, a single individual can escape poverty, but a parent with one child cannot. Moreover, many poor families have other options that they would be foolish to ignore. In fifteen states, a single parent with two children is better off on welfare than she would be working full-time at the minimum wage.[3]

In 1986, 6 million households, 44 percent of all poor households, were poor despite the work effort of the household head.[4] As shown in Table 1, working poor households are predominantly white, married couples or unrelated individuals, with only one worker in the family. Half have at least one child under 18, and one quarter have a child less than six years old. Approximately two-thirds of working poor household heads work full-time when they work, but many do not work the full-year. Only 26 percent of all working poor households is headed by someone who works full-time for the entire year. Another one-third is headed by someone working more than 26 weeks but less than full-time, full-year, and 41 percent is headed by someone working less than 26 weeks during the year.

Making work pay is a good way to increase employment among those who are currently working less than full-time or who are dependent on welfare. The Employment Incentives Act would increase the "effective wage rate" by 23 cents per hour, for a full-time, minimum-wage worker with one child.[5] This would not only increase the earnings of low wage workers, but could also increase hours worked by as much as 0.9 percent among able-bodied, underemployed and

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1. See Isabel V. Sawhill, "Poverty and the Underclass," in The American Agenda, Report to the Forty-First President of the United States, Washington, DC: The American Agenda, November 1988.

2. See Isabel V. Sawhill, "Poverty and the Underclass," in Isabel V. Sawhill, editor, Challenge to Leadership: Economic and Social Issues for the Next Decade, Washington, DC: The Urban Institute Press, 1988; and Ronald B. Mincy, "Minimum Wage Increases and the Working Poor," The Urban Institute, Washington, DC, May 2, 1988 [DRAFT]).

3. Welfare is here defined as the combined AFDC and food stamp benefits available to a non-working family.

4. Both the terms households and families are used to refer to the combination of families and unrelated individuals as defined by the Census.

5. By 1991 when the income cap will be above full-time minimum wage earnings assuming the current minimum wage level of $3.35.

non-working poor household heads, an increase of 13,200 full-time equivalent people.[6] However, in order for such employment effects to occur, it will be important to publicize the impact of the program on effective wage rates in welfare offices and other places.

The goal that no person that makes a reasonable effort to support a family should be poor is laudable, but the issues involved in how to structure any new assistance to the working poor are complex and need to be sorted out prior to enacting new legislation. In the remainder of this testimony I address some of these issues in the hopes that it will be useful to this Committee.

Coverage

The Employment Incentives Act would directly benefit a significant number of poor families where the head is already working. However, because coverage is limited only to families that both work and have children, it is important to remember that the EITC and the Dependent Care Tax Credit assist only one-fifth of all poor households (Table 2). Of those who are not eligible, 39 percent have heads who are elderly or disabled--a group that this legislation is not intended to help. Twenty-nine percent have heads who are working but have no children, and 32 percent are not currently working.[7] Almost half of those not currently working are potentially eligible because they have children to support. One option would be to expand the EITC to cover working poor households without children. If one limited this option to full-time workers, it would add only 644,000 households to the eligible population.

Adjustments for Family Size

Indexing the EITC for family size may be sensible, particularly in light of the fact that welfare benefits and other transfers vary with family size and that society has an interest in assuring that children have adequate resources. The issues would seem to be (a) whether to add any additional family size brackets beyond the first or second child and (b) how much to vary the credit with family size. On the one hand, only 14 percent of all poor households have 3 or more children. On the other hand, 57 percent of all poor children live in households where there are 3 or more children (Table 4). Those who put primary emphasis on assisting children might want to have at least one additional size bracket. Those who attach more importance to the responsibility of parents to limit the size of their families to what they can afford to support, and who may be concerned about the reaction of middle-class taxpayers to unlimited subsidies for childbearing, may prefer the current proposal or even one that eliminates a family size adjustment entirely.[8]

With respect to the amount of the family size adjustment, a second child in a family where the head works full-time at the minimum wage nets that family an additional $627 per year. This is less than the $1,726 increase in the poverty line for a 4- vs. a 3-person family. However, it is

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6. Weighting Masters and Garfinkel's estimate of the change in work effort resulting from benefit reductions by the demographic characteristics of the EITC population results in a 1.3 percent change in work efforts per 10 percentage point increase in the EITC benefit rates. (See Stanley Masters and Irwin Garfinkel, Estimating the Labor Supply of Income Maintenance Alternatives, New York: Academic Press, 1977.)

7. This calculation is based on the date in Tables 2 and 3. Note that a small number of elderly and disabled heads (363,000) are eligible because they both work and have children.

8. Adding a 35 percent rate for families with 3 or more children, could cost an additional 0.7 billion dollars in 1992 if all 1.9 million poor households with 3 or more children earned the maximum amount.

more than the extra $345 in tax relief per child provided to a low-income family not eligible for the EITC.[9] My own view is that the poverty line overadjusts for family size and that something closer to the value of the personal exemption might be preferable.

Work Incentives

In order to maximize work incentives, it is desirable to set the EITC income cap (the income level at which benefits reach their maximum) at or above full-time minimum wage earnings, currently $6,968. This minimum-wage earnings level could increase to as much as $9,672 by 1992 under congressional proposals to increase the minimum to $4.65. At an inflation rate of 5 percent per year between now and 1992, the income cap under the proposed Employment Incentives Act will be $7,508 in 1992. Thus, the EITC would provide no incentive for the $4.65-an-hour earner to work more than 41 weeks per year. For this reason, it may be desirable to adjust the income cap in line with any changes in the minimum wage.

It is also desirable to keep marginal tax rates in the phase out range as low as possible. A single parent with two children and $15,000 of earned income would pay a marginal tax rate of about 43 percent (15 percent in income taxes, 7.7 percent in Social Security taxes and 20 percent because of the phase-out of the EITC). Although this is not prohibitive, it is high enough to give one pause.

The Dependent Care Tax Credit

If the Dependent Care Tax Credit is retained it should be made refundable as called for in the Employment Incentives Act. Currently the credit is highly regressive and offers little, if any, assistance to the working poor. Only 3 percent of the credit goes to families in the bottom 30 percent of the income distribution. Making the credit refundable would make 1.7 million more poor families eligible, and potentially increase the percent of the credit going to the bottom 30 percent of the income distribution to 17 percent.[10] However, even with a refundable provision, many working poor families may not benefit from the credit. Only a third of low-income families with preschool age children pay for child care.[11] Moreover, if those that do pay cannot afford spending much for care, a 30 percent subsidy is of small dollar value and does little to assure quality care. Finally, the Family Support Act requires that those claiming the credit provide the IRS with the taxpayer ID number of their day care provider--a requirement that will tend to disqualify many low-income families who tend to use informal child care arrangements.

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9. This represents 15 percent of the estimated $2,300 personal exemption in 1992.

10. Roberta Ott Barnes and Linda D. Giannarelli, "The Distributional Effects of Alternative Child Care Proposals," The Urban Institute, Washington, DC, 1988. (Paper presented at the 10th annual meetings of the Association for Public Policy Analysis and Management, Seattle, WA, October 17-19, 1988.)

11. According to the Census Bureau only 36 percent of families with incomes under $15,000 with preschool age children used child care arrangements where cash payment is common. (U.S. Department of Commerce, Bureau of the Census, "Child Care Arrangements of Working Mothers: June 1982", Series P-23, No. 129, Washington, DC: U.S. Government Printing Office, 1983.)

Adequacy

Although the Employment Incentives Act will help the working poor, it will not move most of these families above the poverty line. To accomplish the latter would require (a) making it still more generous which would greatly escalate budgetary costs at current marginal tax rates or (b) combining it with an increase in the minimum wage. Table 5 shows the effect on the 1992 earnings of full-time, full-year minimum-wage earners of different proposals and combinations of proposals.[12]

The proposed revisions in the EITC alone would not be sufficient to raise the earnings of even a single parent household with one child over the poverty line. They would, however, increase the income of a single parent with one child by $487, with two children by $1,187, and reduce the poverty gaps of both families by one third.

Raising the minimum wage to either the $4.65 level of the Minimum Wage Restoration Act (S.4) or to the $4.25 level with a $3.35 training wage being proposed by the Administration, would have a greater effect on the earnings of a full-time minimum wage worker. By itself, an increase in the minimum wage to $4.65 would be sufficient to move a single parent with one child, above the poverty line. In conjunction with the EITC changes, it would lift a single parent with two children above the poverty line.

The increase in the minimum wage proposed by the Administration would be sufficient to raise a single parent with one child above the poverty line only in those households where the head is not a new hire.

Of all the proposals only the combination of a $4.65 minimum wage, the new EITC provisions and a refundable Dependent Care Credit would provide sufficient earnings to raise a two-parent household with children above the poverty line at full-time, full-year minimum wage earnings.

Minimum Wages vs. the EITC

Raising the minimum wage is clearly a more powerful tool for increasing the earnings of low-wage workers than the changes in the EITC under consideration. It is, however, not necessarily a preferable alternative, nor a substitute, for adjustments in the EITC to assist working poor families.

Although raising the minimum wage would clearly help working poor families, it is also a poorly targeted strategy for doing so. On the one hand, raising the minimum wage to $4.65 would assist 61 percent of the workers from poor families.[13] On the other hand, only 15 percent of all of the earners affected by increasing the minimum wage to $4.65 live in poor families (Table 6).[14]

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12. 1992 was chosen because that is when the minimum wage increase proposed in the Minimum Wage Restoration Act, (S 4), will be fully-phased in.

13. In 1986, 3.7 million workers from poor families were paid hourly wages. As shown in Table 7, 2.3 million of these poor workers, or 61 percent, earned less than $4.65 in 1986, 2.1 million, or 57 percent, earned less than $4.35.

14. As shown in Table 6, of the 4.5 million workers earning at or below the minimum wage in 1986, only 18 percent were in poor families. As the table also indicates, 64 percent were females, 84 percent were white, 62 percent were adults, 83 percent worked less than full-year, full-time, and 80 percent worked in retail trade and service industries.

A six-month, subminimum wage for new workers would not only reduce the anti-poverty effectiveness of the increase as shown in Table 5, but it could apply to a large proportion of low-wage earners. Based on unpublished job tenure data from the Bureau of Labor Statistics, we estimate that 40 percent of low-wage workers (those earning less than $4.35 in 1986) would be eligible to receive the subminimum wage for new hires during the year.[15]

Even if the minimum wage is increased to $4.65, the overall effects on reducing poverty are likely to be small, although larger than opponents commonly suggest.[16] Incorporating the loss of jobs by some poor workers, Ron Mincy of the Urban Institute has estimated the net effects of an increase in the minimum wage to $4.35 and $4.65.[17] He finds that an increase to $4.65 could reduce the poverty gap by as much as $1.4 billion. This is a small proportion of the total poverty gap which was $48 billion in 1986.

Raising the minimum wage is also likely to increase inflation. The Congressional Budget Office estimates that an increase to $4.65 could add 0.1 to 0.3 percentage points to the inflation rate. Should a recession (or a deeper recession than might otherwise occur) be needed to offset these inflationary costs, the negative impact on the working poor could conceivably outweigh any benefit from the minimum wage increase. There is reasonably strong and consistent evidence that recessions have a disproportionate impact on the poor and widen the distribution of income.[18] Given the possible inflationary costs of raising the minimum wage, it might be preferable to have a more generous EITC even though this has obvious budgetary costs.

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15. In the retail trade and service industries which employ 79 percent of hourly workers at or below the minimum wage, 25 percent of adults aged 25 or over had been with their current employer less than one year in 1987. Among teenagers, 79 percent had been with their employer less than one year.

16. Larger because the disemployment effects resulting from a minimum wage increase are not as great as critics contend. Evidence suggests that employment is relatively inelastic with respect to a minimum wage increase. Estimates of the elasticity of employment with respect of a minimum wage increase are less the -.10 for young adults and between -.10 and -.30 for teens. (Brown, Gilroy and Kohen, "The Effect of the Minimum Wage on Employment and Unemployment", Journal of Economic Literature, Vol. XX, pp. 487-528, June 1982, cited in Ronald Mincy, "Minimum Wage Increase and the Working Poor," The Urban Institute, Washington, DC, 1988.) More recent estimates suggest even smaller elasticities. (Isaac Shapiro, No Escape: the Minimum Wage and Poverty, Washington, DC: Center on Budget and Policy Priorities, June 1987.)

17. An increase to $4.35 would reduce the $8 billion poverty gap among working poor families by $1 billion, a 12.7 percent reduction, and the number of working poor families by 200,000, a 9 percent reduction. It would increase the average income of poor families with low wage workers by $592. An increase to $4.65 would reduce the poverty gap by an additional 5.2 percent, $380 million, and the number of working poor families by 11.8 percent, 64 thousand. The average income of poor families with low wage workers is increased by an additional $172. Ronald Mincy, "Minimum Wage Increase and the Working Poor," The Urban Institute, Washington, DC, 1988.

18. For a review of the evidence see Isabel V. Sawhill, "Poverty in the U.S.: Why Is It So Persistent?" Journal of Economic Literature, Vol. XXVI, pp. 1073-1119, September 1988.

Concluding Comments

The long-term solution to the inadequate incomes of the working poor needs to emphasize education, training, and strengthening family responsibilities. (In the latter connection, some thought might be given to making anyone who pays child support eligible for the EITC whether or not they have a dependent living with them.) In the meantime, I believe the Employment Incentives Act is a step in the right direction. It should improve work incentives, reduce welfare dependency, and lead to higher incomes for the working poor. However, adjustments in the EITC alone are insufficient to move most working poor families above the poverty line. To achieve this goal, a combined adjustment in the EITC and an increase in the minimum wage would be needed.

In conclusion, let me once again commend the Committee for its focus on the working poor. I appreciate this opportunity to testify and would be happy to help in any way I can to further your work on this important issue.

TABLE 1

CHARACTERISTICS OF WORKING POOR HOUSEHOLDS
By Characteristics of The Household Head
1986

Characteristic	Number Households (000)	Percent of Working Poor Households (%)
Total Poor Households	13,869	
Householder Worked	6,146	100.0
Amount of Work		
Full-time,Full-Year	1,595	26.0
More Than 26 Weeks, Less Than Full-time, Full-Year	2,029	33.0
Less than 26 Weeks	2,522	41.0
Hours of Work		
Part-time	2,270	36.9
Full-time	3,876	63.1
Race		
White	4,666	75.9
Nonwhite	1,480	24.1
Age		
22 to 64 Years	5,198	84.6
Other	948	15.4
Family Type		
Unrelated Individual	2,646	43.1
Married-Couple	1,877	30.5
Female-Headed	1,450	23.6
Other	173	2.8
Children		
Related Children < 18	2,964	48.2
Related Children < 6	1,724	28.1
No Related Children	3,182	51.8
Residence		
Metropolitan	2,240	64.0
Nonmetropolitan	1,260	36.0
Inside Poverty Area	1,172	33.5
Outside Poverty Area	2,328	66.5
Number of Workers		
None	---	---
One worker	4,818	78.4
Two workers	1,125	18.3
Three or More	203	3.3

SOURCE: U.S. Census, Current Population Reports, Series P-60, No. 160.
NOTE: Household counts include both families and unrelated individuals except calculations by residence, which include only families.

TABLE 2

Poor Households By Work-Effort and Presence of Children
1986

Households	TOTAL POOR HOUSEHOLDS (000)	WORKING POOR		
		TOTAL (000)	Full-Time Full-Year (000)	Other (000)
Total	13,869	6,146	1,595	4,551
No Children	8,353	3,182	644	2,538
Children	5,516	2,964	951	2,013
Female-Headed Household	3,264	1,345	255	1,090

SOURCE: U.S. Census, Current Population Reports, P-60, No. 160.
NOTE: Poor households include both families and unrelated individuals.

TABLE 3

Work Effort Among the Able-Bodied Poor
By Labor Force Participation of the Family Head
1986

	HOUSEHOLDS	
	Number (000)	Percent (%)
TOTAL POOR	13,869	100.0
Elderly And Disabled	4,686	33.8
Able-Bodied	9,183	66.2
TOTAL ABLE-BODIED POOR	9,183	100.0
Total Working	5,732	62.4
Hardworking	1,520	16.6
Underemployed	4,212	45.9
Non-workers	3,451	37.6

SOURCE: U.S. Census, Current Population Reports, P-60, No. 160.
NOTE: Households include families and unrelated individuals. Able-bodied includes all households in which the head is not elderly or disabled. Hardworking poor includes all households in which head is employed full-year,full-time. Underemployed poor include all households in which head is employed part-year, part-time or both.

TABLE 4
Poor Households and Poor Children
By the Number of Children In the Household
1986

Characteristic	TOTAL (000)	No Children (000)	One Child (000)	Two Children (000)	Three Or More Children (000)
All Poor Households	13,869	8,353	1,817	1,792	1,907
Percent	100.0	60.2	13.1	12.9	13.8
All Poor Children	12,548	0	1,817	3,584	7,147
Percent	100.0	0.0	14.5	28.6	57.0

SOURCE: U.S. Census, Current Population Reports, P-60, No. 160.
NOTE: Poor households include both families and unrelated individuals.

TABLE 5

1992 Earnings Levels for Family Heads Working
Full-Time, Full-Year at the Minimum Wage
By Number of Children
Under Various Policy Scenarios

POLICY SCENARIO	EARNINGS (In dollars)		
	No Children	One Child	Two Children
Current Law for Both Minimum Wage and EITC	$6,960	7,944	7,944
New EITC Only	6,960	8,431	9,050
Administration Minimum Wage Only			
New Hire	7,904 *	8,955	8,955
Not a New Hire	8,840 *	9,891 *	9,891
Democratic Minimum Wage Only	9,672 **	10,723 *	10,723
Administration Minimum Wage + New EITC			
New Hire	7,904 *	9,481 *	10,156
Not a New Hire	8,840 *	10,417 *	11,092
Democratic Minimum Wage + New EITC	9,672 **	11,249 *	11,924 *
Democratic Minimum Wage + New EITC + Refundable Dependent Care Credit	9,672 **	11,969 **	13,364 *
Poverty Line			
Unmarried Individual or Single Parent Household	7,235	9,262	11,139
Married Couple or Two Parent Household	9,262	11,339	14,538

KEY: * Above poverty line for unmarried individual and single parent household.
** Also above poverty line for married couple and two parent household.

SOURCE: Urban Institute Calculations based on data from the Current Population Survey, Congressional Budget Office, Testimony of Secretary of Labor, The Employment Incentives Act (H 882), and the Minimum Wage Restoration Act (S 4).

NOTE: a. Current minimum wage is $3.35/hour; Administration minimum wage is $3.35 hour for a new hire and $4.25 after the first 6 months; Democratic minimum wage is $4.65/hour as proposed in the Minimum Wage Restoration Act (S 4); New EITC refers to the proposals contained in the Employment Incentives Act (HR 882).
b. Not including social security and personal income taxes.
c. Assumes 4.9 percent inflation for 1989 (CBO estimate) and 5 percent inflation/year for 1990-1992.
d. Assumes child care expenditures of at least $2,400 per child.

TABLE 6

WHO EARNS LOW WAGES?
Workers Paid Hourly Wages By Selected Characteristics
1986

Category	$3.35 or Below (000)	$3.36 to $4.34 (000)	$4.35 to $4.65 (000)	Over $4.65 (000)	TOTAL (000)
TOTAL EARNERS	4,471	8,537	1,880	39,727	54,614
NUMBER EARNERS					
SEX					
Male	1,592	3,142	617	21,813	27,164
Female	2,879	5,395	1,262	17,914	27,450
RACE					
White	3,763	7,007	1,550	33,575	45,902
Nonwhite	708	1,530	322	6,152	8,712
AGE					
Teenager	1,691	1,963	244	1,070	4,968
Adult	2,781	6,574	1,636	38,656	49,646
POVERTY STATUS					
Poor	822	1,270	166	1,432	3,698
Near Poor	301	489	119	1,099	2,008
Not Poor	3,349	6,770	1,594	37,195	48,908
PRESENCE OF OTHER WORKERS					
Other Worker	3,267	6,137	1,375	26,771	37,551
No Other Worker	1,204	2,399	504	12,956	17,064
HOURS WORKED					
Full-time, Full-Year	765	2,272	719	26,513	30,270
Other	3,706	6,265	1,161	13,213	24,344
METROPOLITAN RESIDENCE					
In SMSA	3,101	6,160	1,460	32,243	42,964
Not In SMSA	1,371	2,376	419	7,483	11,650
INDUSTRY					
Agriculture/Fishing/Forestry	65	172	45	410	693
Mining	9	23	6	471	509
Construction	60	157	64	3,216	3,497
Manufacture	307	1,084	266	10,108	11,766
Transportation/Communication/Utilities	39	134	33	3,998	4,204
Wholesale Trade	49	223	34	1,202	1,508
Retail Trade	2,306	3,787	620	5,009	11,721
Finance/Insurance/Real Estate	11	250	105	1,726	2,093
Service - Private House	299	128	6	155	588
Service - Not Private House	1,258	2,490	679	11,477	15,904
Public Administration	59	68	11	1,838	1,976
No Classification	8	20	11	116	154

SOURCE: Urban Institute tabulations of the March 1987 Current Population Survey.
NOTE: Total earners includes all wage and salary workers aged 16+ who are paid hourly wages. Poor refers to workers in families with incomes below the poverty line. Near poor means family income is between 100% - 125% of the poverty line. Teenagers are aged 16-19.

TABLE 7

The Estimated Number of Workers
Affected By Various Proposals to Adjust
The Minimum Wage
1986

	Total Earners				
Employed at or Below	Total Number of Earners (000)	Percent of Earners at or Below Minimum (%)	Poor Earners Number (000)	Poor Earners Percent (%)	Percentage Of All Poor Hourly Earners (%)
Total All Levels	54,614	—	3,698	6.8	100
Current Minimum: $3.35	4,471	100	822	18.4	22.2
Minimum Wage of $4.34	13,008	100	2,099	16.1	56.8
With Subminimum for Teens					
Employed at Minimum	9,354	71.9	1,713	18.3	46.3
Employed at Subminimum	3,654	28.1	386	10.6	10.4
With Subminimum for New Hires					
At Minimum Wage	7,766	59.7	1,363	17.6	36.9
At Subminimum During Year	5,242	40.3	736	14.0	19.9
Minimum Wage of $4.65	14,888	100	2,266	15.2	61.3
With Subminimum for Teens					
Employed at Minimum	10,990	73.8	1,863	17.0	50.4
Employed at Subminimum	3,897	26.2	403	10.3	10.9
With Subminimum for New Hires					
At Minimum Wage	9,042	60.7	1,479	16.4	40.0
At Subminimum During Year	5,845	39.3	787	13.5	21.3

SOURCE: Urban Institute Calculations based on minimum wage data from the 1987 Current Population Survey, & unpublished Bureau of Labor Statistics data on Job Tenure, 1987, data on Job Tenure, 1987.
NOTE: A wage of $4.34 is used because data for $4.25 is unavailable. Earners are all wage and salary earners paid hourly rates. Poor earners are workers in poor families. The number of earners affected by the subminimum wage is calculated based on the proportions of workers with tenure of less than one year with their current employer. For teenagers, 79% of teens aged 16-19 had been with their current employer for less than one year in 1987.(BLS) For adults age 20+ the proportion affected by the subminimum for new hires is based on the fact that 24.1% of adults age 25+ had been with their current employer less than one year in the industries which employed 79% of hourly workers at or below the minimum wage in 1986, retail trade and service not in private house.(BLS, & The Urban Institute). These proportions probably underestimate the number of workers affected by the subminimum wage because they ignore adjustments in the small business exemption, the higher less-than-one-year tenure rate among 20-24 year olds, and the potentially higher rates among poor workers. (40% of poor household heads worked less than 26 weeks in 1986.)

Acting Chairman DOWNEY. Thank you, Dr. Sawhill. We are going to hear from Mr. Bauer and Ms. Edelman, and then we will ask some questions.

STATEMENT OF GARY L. BAUER, PRESIDENT, FAMILY RESEARCH COUNCIL

Mr. BAUER. Thank you, Mr. Chairman. I would like to thank you for the opportunity this morning to testify before your subcommittee about the financial pressures facing families with dependent children, and I want to applaud your subcommittee's interest in revising the Federal Income Tax Code to ease the tax burden on these families.

I hope you agree that family economic problems can generally be addressed more equitably and efficiently through tax code revisions than through Government spending programs. Rather than promoting dependency on Government programs, tax-oriented approaches encourage self-sufficiency and family autonomy by allowing employed parents to keep more of their own earned income.

I would also like to congratulate you, and I hope that it doesn't cause you too many unnecessary problems to have a former Reagan Administration official commending you on this, but I would congratulate you on those provisions of your bill that make changes in the Earned Income Tax Credit to reflect variations in family size. We do believe that that is moving in the right direction.

I would urge you, if you haven't already, to take a look at some other proposals, including one by Congressman Petri. It makes the further adjustment of reflecting the fact that there are differences in costs for families between pre-school children and those of school age. We think that also is a change that is worth considering.

In addition, Mr. Chairman, we do think there are some problems with your proposal. Let me address one of them. For years the Congress and successive administrations dealt with what was called a marriage penalty. We believe that a similar type of penalty exists in the Tax Code today, and I think it could be called, in all fairness, a parenting penalty.

By tying tax benefits to child care expenses, the current Dependent Care Credit perversely rewards parents for not spending time with their children. Generally, the more time a child spends in substitute care, the greater the family's day care expenses, and the greater the day care expenses, the higher the family's tax credit.

Essentially, the credit redistributes income from families that make little or no use of paid day care to those that make extensive use of such services. Not only does this credit penalize families in which one parent stays home full time to care for children, but it also shortchanges two-income and single-parent families that seek to minimize their use of nonfamilial substitute care by working part time, working different shifts, working from home, or having a grandparent or other relative care for their children.

Despite the fact that the Dependent Care Tax Credit penalizes parenting, there are those who defend it by asserting that paid care is a necessary precondition to employment. While it is true that most employed parents must have someone care for their chil-

dren while they are at work, paid child care is not a necessary precondition to employment.

In fact, a recent Census Bureau survey of child care arrangements found that half of all preschool children with employed mothers are primarily cared for outside the paid day care market by a family member, usually the father or a grandmother. Indeed, one of the reasons why low income families receive a much lower average benefit from the Dependent Care Tax Credit than higher income families is because many poor working families make extensive use of unpaid care by relatives.

We think there are a number of practical benefits to constructing what I would call a new Family Wage Tax Credit that breaks the link between child care expenses and tax benefits, and we think this would help all families. First, it would encourage economic self-sufficiency without penalizing parenting.

Welfare reform efforts during the last few years have focused a great deal of attention on reducing dependence on Government programs. While these efforts to encourage economic self-sufficiency need to continue, they should be complemented with a recognition that parents need to do more than just provide for their family's economic needs. They also need to invest time in the lives of their children. Earned income tax measures that do not penalize parenting are designed to meet both of these goals.

Second, target tax relief to low income families. While the Earned Income Tax Credit has always been directed at the working poor, the Dependent Care Tax Credit, as you know, has in some ways been a boon to higher income people. In 1985, the average tax benefit for a family earning less than $10,000 was $247. In the same year, families making more than $200,000 a year enjoyed an average tax benefit of $515. We would submit that there is a problem of equity there.

Third, we believe that a proposal like this could enhance the quality of substitute care. In hearings earlier this year before a Senate subcommittee, a licensed family day care provider noted that parents strongly prefer family day care over center-based care for their infants and toddlers, and she noted that most family day care providers are themselves mothers of preschool children who care for their own children while offering substitute care to other families. This provider said that offering a tax credit to all families with children, rather than to just those who pay for care, would prevent some family day care providers from feeling economic pressure to take in more children than they are adequately able to care for.

Fourth, we think this kind of an approach might avoid what I would call preschool policy schizophrenia. If parenting leave legislation were enacted and no changes were made in the current Dependent Care Tax Credit, the Federal Government would be simultaneously urging parents to take leave from their jobs to care for their newborns, while offering a tax break only to those families that refused such leave and paid for child care outside the home.

Fifth, we believe it is important to maximize parental choice and autonomy. Allowing parents with young children to keep more of their own earned income strengthens their economic standing and

gives them greater autonomy over important life decisions, such as how to care for their children.

While a new Family Living Wage Tax Credit would not penalize familial care of children, neither would it penalize families who must rely on some form of paid substitute care. Indeed, by giving parents the freedom to use their tax credit as they see fit, this credit ensures that parents will find it easier to provide or purchase the child care arrangements of their choice.

Again I commend you for the general direction you are moving in, and I would hope that you would be willing to discuss some of these equity issues, to perhaps form a larger coalition of conservatives and liberals that might be able to agree on the approach to take. Thank you, Mr. Chairman.

[The statement of Mr. Gary Bauer follows:]

TESTIMONY OF GARY L. BAUER

Before the
Human Resources Subcommittee
of the Ways and Means Committee
U.S. House of Representatives

March 21, 1989

MR. CHAIRMAN, I want to thank you for giving me the opportunity to testify before your subcommittee this morning about the financial pressures facing families with dependent children, and I want to applaud your subcommittee's interest in revising the federal income tax code to ease the tax burden on these families.

As your committee apparently recognizes, family economic problems can generally be addressed more equitably and efficiently through tax code revisions than through government spending programs. Rather than promoting dependency on government programs, tax-oriented approaches encourage self-sufficiency and family autonomy by allowing employed parents to keep more of their own earned income.

MR. CHAIRMAN, you are to be congratulated for introducing legislation that expands the earned income tax credit and makes it responsive to variations in family size. These are reforms which are long overdue -- reforms which liberals and conservatives can enthusiastically embrace.

Apart from these changes, I believe a newly constructed earned income credit should also take into consideration variations in the age of children covered by this credit. Specifically, I would encourage your committee to take a long look at legislation recently introduced by Congressman Petri which offers a significantly higher earned income credit for preschool children than for school-age children.

Congressman Petri's bill, the Family Living Wage Act, makes this distinction since families with preschool children typically face higher child care costs (in foregone wages and/or actual out-of-pocket expenses) than families with school-age children. In essence, his proposal is designed to provide income support and tax relief to low-income taxpayers, and to correct a serious flaw in the current configuration of the Dependent Care Tax Credit.

Under current law, the Dependent Care Tax Credit penalizes parenting. By tying tax benefits to child care expenses, the current dependent care credit perversely rewards parents for <u>not</u> spending time with their children.

Generally, the more time a child spends in substitute care, the greater the family's day care expenses. And the greater the day care expenses, the higher the family's tax credit.

Thus, the current Dependent Care Tax Credit discourages parent-child interaction by increasing the "opportunity cost" (in foregone after-tax earnings) that parents pay to spend time with their children. Essentially, the credit redistributes income from families that make little or no use of paid day care to those that make extensive use of such services.

Not only does this credit penalize families in which one parent stays home full time to care for children, but it also shortchanges two-income and single-parent families that seek to minimize their use of non-familial substitute care by working part-time, working different shifts, working from home, or having a grandparent or other relative care for their children.

Despite the fact that the Dependent Care Tax Credit penalizes "parenting," there are those who defend it by asserting that paid child care is a necessary precondition to employment.

While it is true that most employed parents must have someone care for their children while they are at work, <u>paid</u> child care is not a necessary precondition to employment. In fact, a recent Census Bureau survey of child care arrangements found that half of all preschool children with employed mothers are primarily cared for outside the paid day care market by a family member (usually the father or a grandmother). Indeed, one of the reasons why lower-income families receive a much lower average benefit from the Dependent Care Tax Credit than higher-income families is because many poor working families make extensive use of unpaid care by relatives.

Supporters of the current Dependent Care Tax Credit are quick to point out that all employed parents do not have flexible work arrangements and extended family networks which permit them to minimize their use of paid child care. While this is true (and lamentable), it serves as no justification for tying tax credits to day care expenses. Indeed, doing so only penalizes families that make financial sacrifices to care for their own children and undermines efforts to develop more flexible work arrangements for employed parents.

Since the Dependent Care Tax Credit cannot be credibly defended by arguing that paid day care is a necessary precondition to employment, supporters of the current credit often turn to a second argument to justify linking tax benefits to day care expenses. They argue that families that make extensive use of paid child care are deserving of special tax benefits since they use their after-tax earnings to pay for child care while families that primarily care for their own children receive their child care "free."

Not only does this reasoning overlook the significant "opportunity cost" (in foregone wages) that families pay to care for their children, but it implies that people who hire housekeepers, butlers, gardeners, interior decorators, and chauffeurs are also deserving of special tax breaks since they use their after-tax earnings to purchase services that other people provide "free" for themselves.

Of course, defenders of the current Dependent Care Tax Credit see a big difference between giving families a tax break for child care expenses and giving people a write-off for hiring a chauffeur. Caring for children is, after all, an investment in our future nation, economy and culture.

Here, dependent care credit proponents are right. Caring for children is of far greater social value than hiring a butler, buying a poodle, or making some other discretionary expense. It is an investment in our future. But if the justification for the current Dependent Care Tax Credit is based upon the fact that child care is an investment rather than a discretionary expense, there is no reason why this tax credit should be denied to those families who invest in children outside the paid day care market.

An investment is an investment whether it is paid in time or paid in money. Indeed, most child development experts would argue that the investment of parental time in a child's life is more important (or, to use economic terms, pays greater long-term dividends) than the investment of parental money.

Given the significance of parental time with children, the tax code should in no way penalize taxpayers who forego extra income to spend substantial amounts of time with their children. Instead, the tax code should be configured to reduce the tax burden on all families with children and give parents as much latitude as possible in determining whether and how much paid substitute care they should use.

Thus, there are a number of practical benefits to constructing a new "family wage" tax credit (that breaks the link between child care expenses and tax benefits). This new credit would:

1. Encourage Economic Self-Sufficiency Without Penalizing Parenting. Welfare reform efforts during the last few years have focused a great deal of attention on reducing dependence on government programs. While these efforts to encourage economic self-sufficiency need to continue, they should be complemented with a recognition that parents need to do more than just provide for their family's economic needs -- they also need to invest time in the lives of their children. Earned income tax measures that do not penalize parenting are designed to meet these twin goals. They are designed to help parents meet their responsibilities as providers and nurturers.

2. Target tax relief to lower-income families. While the EITC has always been directed at the working poor, the Dependent Care Tax Credit has long been a boon to the rich. In 1985, the average tax benefit for a family earning less than $10,000 was $247. In the same year, families making more than $200,000 enjoyed an average tax benefit of $515 under the Dependent Care Tax Credit.

Moreover, many lower-income families currently receive no benefit at all from the Dependent Care Tax Credit because they exclusively care for their own children. For example, contrary to popular belief, there are still a number of traditional families (in which one parent stays home full-time with the children) making less than $15,000 a year. In fact, one recent study found that such families actually outnumber employed single mothers earning less than $15,000 a year.

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3. Enhance the quality of substitute care. In her recent testimony before a Senate subcommittee, a licensed family day care provider named Deanne Dixon noted that parents strongly prefer family day care over center-based care for their infants and toddlers. And she noted that most family day care providers are themselves mothers of preschool children who care for their own children while offering substitute care to other families. Ms. Dixon said that offering a tax credit to all families with children (rather than just those who pay for care) would prevent some family day care providers from feeling economic pressure to take in more children than they are able to adequately care for. In other words, a universal tax credit would enhance the quality of family day care by keeping provider-child ratios low.

4. Avoid preschool policy schizophrenia. If parenting leave legislation were enacted and no changes were make in the current Dependent Care Tax Credit, the federal government would be simultaneously urging parents to take leave from their jobs to care for their newborns while offering a tax break only to those families that refused such leave and paid for child care. Obviously, if parenting leave is desirable — and it is — then the tax code should not penalize those that take such leave.

5. Maximize Parental Choice and Autonomy. Allowing parents with young children to keep more of their own earned income strengthens their economic standing and gives them greater autonomy over important life decisions, such as how to care for their children. While a new Family Living Wage Tax Credit would not penalize familial care of children, neither would it penalize families who must rely on some form of paid substitute care. Indeed, by giving parents the freedom to use their tax credit as they see fit, this credit ensures that parents will find it easier to provide or purchase the child care arrangement of their choice.

MR. CHAIRMAN, I am pleased that your committee is looking seriously at the need to reduce the tax liability on families with dependent children. And I am hopeful that your committee will seize this opportunity to correct the flaws in the current Dependent Care Tax Credit by folding it into a new tax credit matrix like that designed by Congressman Petri.

I am happy to entertain any questions you may have and would welcome the opportunity to work with you in developing a legislative vehicle that not only lifts the tax burden on poor working families, but on middle-income parents as well.

Acting Chairman DOWNEY. Thank you, Mr. Bauer.
Mrs. Edelman.

STATEMENT OF MARIAN WRIGHT EDELMAN, PRESIDENT, CHILDREN'S DEFENSE FUND, ACCOMPANIED BY HELEN BLANK

Mrs. EDELMAN. Good morning, Mr. Chairman.

I think all of those women and men who are on waiting lists for quality child care will be surprised to hear that grandma and their husbands can meet that need. I think that the facts belie that.

I want to thank the subcommittee for holding these hearings, for its new proposals. I think it comes at an extraordinarily important time, because our children are growing poorer while this Nation is growing richer. The subcommittee has been very diligent in analyzing poverty among children and families and understanding its complexities and dimensions. It has taken the lead on a variety of policies—tax credits, child support, Aid to Families with Dependent Children—all of which are designed to bolster the income of poor children and families, and I am deeply grateful.

We support and like very much the expansion in the Chair's proposal to the EITC and its adjustment for family size. It is a natural expansion of the progress with the EITC that was made, thanks to your leadership, in the Tax Reform Act. We support and have long worked for making the Dependent Care Tax Credit refundable, as your bill proposes. We have for years fought for an increase in the funding for Title XX.

As this subcommittee has recognized, however, we do need a variety of policies, and the development of the Family Support Act and income support policies are not alone sufficient to deal with all the problems of the working poor. Congress must also pursue housing policies that effectively address the increasing homelessness among poor children and families, many of them working. It must enact health care policies that address the increasing lack of health insurance of poor children and families, again, many of them working; and it must similarly enact child care policies that address the lack of safe and affordable care for the children of low-income working parents. I am grateful that the Chair and many other members of this committee have agreed to cosponsor the Act for Better Child Care Services.

If we do not try to deal with the child care needs and the income needs of working families in a holistic way, the employed parents of America will be back on the Capitol steps demanding the help that they need.

While we must do everything we can as quickly as we can to bolster the income of working families and give parents the real choice to stay at home, we also have to deal with the reality of all those mothers who are already out there in the work force and who cannot find safe child care. The fact is, we have over 10 million preschoolers and their older siblings who have mothers already working outside the home. We cannot ignore the hundreds of children who are killed or injured each year because of a lack of safe, affordable child care options. We can't forget the countless parents who are stressed out and frustrated because they don't

know what is available, can't find it and, if they can find it, often can't afford it.

Therefore, while we certainly support the Chair's efforts to expand the tax credits and to give more income to working families, it is not an adequate response, as you have recognized, to the waiting lists that abound for good child care in every State. The child care problems in our Nation are complex and immense.

Today's child care crisis has three facets: Working poor parents cannot afford the cost of child care, which would be partially responded to by your proposals. Parents too often cannot be assured that child care will be of good quality. Poor children need that quality even more than our children, because we can afford to supplement what they do or do not get from day care. Finally, parents too often can't be assured that there is child care that is available in their community, because we do have a shortage of quality, available child care options.

Today, half of all the mothers with children under 2 are in the labor force. Many of them are not going to go back home, and we have to deal with that reality. By 1995 it is estimated that two-thirds of all preschool children and four out of five school-age children will have mothers in the work force.

While the cost of quality child care is a struggle for many working families, for the working poor it is nearly prohibitive. Our single mothers who are raising one or more children under 6 had a median income of $6,595 in 1986. The result of this is that we are increasingly facing a two-tier child care system.

Good child care makes a positive and permanent difference to a child's development, especially the development of poor and disadvantaged children, yet the quality of care varies widely from State to State and from provider to provider, and is often so inadequate that it threatens the well-being of the children served. Parents and communities all across the country find it extremely difficult to find good quality care for their children while they are at work. Parents of infants and toddlers face the most difficult task because of the large influx of new mothers into the work force and the fact that infants require more frequent attention and care than older children.

The lack of decent and affordable child care is exacting a heavy toll on parents, on children, and on our competitive status as a Nation. It hinders families' abilities to become self-sufficient, lessens the productivity of parents at work, and undermines the productivity of our Nation's future generations.

Therefore, we strongly urge that we have a national child care policy that ensures the protection and the safety and the development of our children, especially our poorest ones. Secondly, we urge child care policies that provide parents with a variety of real choices for the care of their children.

While tax credits can be an extremely effective income support mechanism, they do not alone address the major child care problems facing working parents and their children. They do not ensure that the lowest income families can pay the cost of decent child care, nor do they improve the quality of child care or expand the supply.

The Employment Incentives Act helps a broader group of families and provides more needed help to families with child care expenses than the tax credit proposal sponsored by President Bush. We applaud you for that and will work very strongly with you to see that its provisions are enacted, but we also will work with you to see that the Act for Better Child Care Services, comprehensive child care legislation, can be enacted to address the child care needs of low-income working families and children and to assure that we build a strong and comprehensive child care system that is made of brick and not of straw.

Thank you.

[The statement and attachments of Marian Wright Edelman follow:]

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TESTIMONY

TO

Subcommittee on Human Resources
COMMITTEE ON WAYS and MEANS

on

PROBLEMS OF THE WORKING POOR

by

Marian Wright Edelman
President, Children's Defense Fund

March 21, 1989

SUMMARY

America's children are growing poorer. By the year 2000, one out of four children will be poor.

Income support policies by themselves are not sufficient to address the growing poverty of children. Congress must also pursue housing policies which address the growing homelessness among poor children and health care policies that address the increasing lack of health insurance for these children. And it must enact child care policies that address the lack of safe and affordable care for the children of low-income working parents.

The child care problems in our nation are complex and immense. Today's child care crisis has three facets. Working poor parents cannot afford the cost of child care. Parents too often cannot be assured that child care will be of good quality. The supply of decent child care falls far short of the need.

By 1995, it is estimated that two-thirds thirds of all preschool children and four out of five school age children will have mothers in the workforce.

While the cost of child care is a struggle for many working families, for the working poor it is prohibitive. America's single mothers who are raising one or more children younger than six had a median income of $6595 (as of 1986). The result is a two-tier child care system.

Good child care makes a positive and permanent difference to a child's development--especially the development of a poor and disadvantaged child. Yet the quality of care varies widely from state to state and from provider to provider and is often so inadequate that it threatens the well-being of the children served.

Parents in communities all across the country find it extremely difficult to find good quality care for their children while they are at work. Parents of infants and toddlers face the most difficult task because of the large influx of new mothers into the workforce and the fact that infants require more frequent attention and care than older children.

The lack of decent and affordable child care is exacting a heavy toll on parents, children, and our competitive status as a nation. It hinders families ability to become self-sufficient, lessens the productivity of parents at work, and undermines the productivity of our future generations.

First and foremost, national child care must ensure the protection, safety and development of our children, especially our poorest children. Second, child care policies must provide parents with a variety of real choices for the care of their children.

While tax credits can be an extremely effective income support mechanism, they do not address the major child care problems facing working parents and their children. Tax credits do not ensure that the lowest income families can pay the cost of decent child care nor do they improve the quality of child care or expand the supply.

The Employment Incentives Act helps a broader group of families and provides more help to families with child care expenses than the tax credit proposal sponsored by President Bush.

The Act for Better Child Care, comprehensive child care legislation, is necessary to address the child care needs of low income working families and children and to assure that we build a child care system out of brick not of straw.

The Children's Defense Fund is a privately funded public charity dedicated to providing a strong and effective voice for children, especially poor and minority children and their families. All of us at CDF greatly appreciate the leadership and attention that Chairman Downey and the Subcommittee have provided to the problems of poor children and families. As you know from your own studies and from earlier testimony, hard work is no longer guaranteed to ward off family poverty. Millions of America's children live in poverty even though their parents are working.

Child poverty is not only growing, it is casting a lengthening shadow as more and more poor children -- often the children of working parents -- are homeless, without health care, and without the child care and early childhood development they need to become healthy, educated and productive adults.

America is a nation growing richer while many of its children grow poorer. The pattern has lasted for nearly 20 years, through four recessions and two long spells of economic growth. We predict that by the year 2000, one out of four children will be poor, a sharp increase from the current shameful rate of one out of five American children in poverty. Unless our nation takes action to effectively reverse these trends, we will see more alarming changes ahead.

Fortunately, children's needs took a bipartisan leap toward the center of the political marketplace during last year's elections, and a strong national consensus appears finally to have been achieved on the importance of early childhood investment. Now that elections are over and the new Administration and 101st Congress are at work, it is time to honor the promises and pledges made and to make the investments our children desperately need.

There are of course no quick fixes, but there are answers. Children's problems, like any national problem, cannot be effectively solved until they are recognized and analyzed and their dimensions understood. This Subcommittee has been especially diligent in analyzing poverty among children and families and understanding its complexities and dimensions. It has taken the lead on a variety of policies -- tax credits, child support, Aid to Families with Dependent Children (AFDC) -- all designed to bolster the income of poor children and families.

As this Subcommittee so clearly recognized in the development of the Family Support Act, however, income support policies are not alone sufficient. Congress must also pursue housing policies that effectively address the increasing homelessness among poor children and families -- many of them working. It must enact health care policies that address the increasing lack of health insurance of poor children and families -- again many of them working. And it must similarly enact child care policies that address the lack of safe and affordable care for the children of low income working parents.

Child Care -- The Problems

Today, we would like to focus on the child care problems that have been catapulted to the top of the national agenda as America's parents, particularly the working poor, face ever-increasing problems finding and affording good quality care for their children.

The child care problems of our nation are as complex as they are immense. When one examines the dimensions of this problem and the frustrations of millions of parents who must work but cannot find or afford decent care for their children, it becomes clear that today's child care crisis has three facets:

- Cost -- Working poor parents cannot afford the cost of child care that now averages $3,000 a year for the full-time care of a single child.

- Quality -- Parents are not assured that child care will be of good quality, or that their children will be safe and protected while they are at work.

- Availability -- The supply of decent child care falls far short of the need with year-long waiting lists for subsidized child care in many parts of the country. Shortages of infant care and before- and after-school care exist nationwide.

Many proposals have been put forth in response to the massive public support for an effective federal child care policy. Some, such as the President's new initiative, utilize tax credits alone, while others, such as the Act for Better Child Care (H.R. 30/S. 5), take a comprehensive direct service approach. If we are to build a child care system of brick and not of straw, we believe that Congress must debate these proposals with the needs of children and families in mind and examine the extent to which they address the cost, quality and supply problems that far too many families now face.

The Children's Defense Fund has prepared a short piece on Child Care: Key Facts which we hope will help Congress and others better understand and effectively resolve the child care problems facing the working poor and other families.

Child care has reached crisis proportions in this country as women, including mothers of young children, have entered the work force in record numbers.

- Sixty percent of all mothers with children now work outside the home. Over half of all mothers with infants younger than age two are now in the workforce.

- By 1995, it is estimated that two-thirds of all preschool children and four out of five of all school age children will have mothers in the workforce.

As the Subcommittee's work confirms, more and more mothers are working primarily out of economic necessity as the proportion of families headed by single mothers increases and the economic status of two-parent families with children declines. Almost a quarter of today's working mothers are the sole support for their children. Often a mother's paycheck is all that stands between her family and their survival.

- Women whose husbands have lower incomes are more likely to work outside the home than women whose husbands have higher incomes. The more the husband earns, the less likely the wife is to work outside the home.

- Almost two-thirds of all mothers in the workforce are single, widowed, divorced, separated, or have husbands who earn less than $15,000 a year.

- In 1986, the median income for all families with children was $29,222 but only $17,500 for young families (families headed by individuals younger than age 30).

The Cost of Care: While child care is absolutely essential for the working poor and key to their ability to achieve self-sufficiency, the cost of care is in most cases simply beyond their reach. It costs an average of $3,000 a year for the full time care of a single child. Care for infants and toddlers is generally most expensive (costing an average of $3,900 for family day care and $4,728 for center-based care).

While the cost of child care is a struggle for many working families, it is prohibitive for the working poor. For example, America's single mothers with one or more children younger than

age six had a median income of $6595 (as of 1986). The annual cost of child care would eat up nearly half their entire income as indicated in the following chart.

INCOME DRAIN

Percentage of Income that Low-Income Parents Would Have to Pay for Child Care

Families	One Child in Child Care (Average Cost: $3,000/yr.)	Two Children in Child Care (Average Cost: $6,000/yr.)
One parent working full time at minimum wage ($6,700 annual income)	45 Percent	90 Percent
One parent working full time, earning poverty-level wages for a family of three ($9,700 annual income)	31 Percent	62 Percent
Two parents working full time at minimum wage ($13,400 annual income)	22 Percent	45 Percent
A single mother with at least one child under six, earning the median wage for that group ($6,600 annual income)	45 Percent	91 Percent
A couple aged 18 to 24 with the median earnings for their age group ($19,900 annual income)	15 Percent	31 Percent

Recently, in a community near Chicago, 47 youngsters -- half of them younger than age two -- were discovered being cared for in a basement by only one adult. At $25 a week, the program was one-third of the cost of most child care in the community. No concerned parent would happily put a child in such a child care situation. But the parents could afford no better. When parents cannot afford decent child care, children suffer and often are placed in care that is dangerous.

The result is our present two-tier child care system in which children of more affluent families attend daycare and preschool programs that are both safe and provide a good foundation for future learning, while children from poor families may be left alone during the day or in unsafe or inadequate care.

Quality of Care: Parents, teachers and child development experts agree that good child care makes a positive and permanent difference to a child's development -- especially the development of a poor and disadvantaged child. Yet the quality of care varies widely from state to state and from provider to provider and is often so inadequate that it threatens the well-being of the children served. For example:

- Eleven states permit five or more babies to be cared for in family day care homes by one person without an assistant.
- Twenty-seven states do not guarantee a parent's right to drop in unannounced at their child's child care center. Thirty-five states do not guarantee unlimited access to their child's family day care home.
- Seventeen states do not require continuing training for teachers while they are employed in child care centers. Twenty-seven states require neither experience nor any form of training for family day care providers.

Parents and child development experts agree on the key factors that determine quality care: a safe and clean place to stay, supervised by a responsible adult who is prepared either through experience or training to care for their children and who

isn't caring for too many children to provide individual attention or handle an emergency. And parents, regardless of where they live, want to be able to drop by to see their children at any time to see how they are doing.

Parents want their children to have a good child care experience. They know that the current system does not provide adequate assurance of that outcome. That is why they overwhelmingly support minimum national standards for child care. In a survey conducted by NBC News and the Wall Street Journal for example, 69 percent of the surveyed public backed such standards.

Employers also understand the importance of good quality child care. The American Express Company recommends national child care standards because it believes that the patchwork of state standards is negatively affecting the mobility of their workforce. CIGNA Corporation, a major insurer of child care centers, also supports national standards to help to reduce the cost of child care insurance and expand its availability as well as to encourage improved safety for children. The U.S. Army realizes the need to establish a minimum floor of quality in their child care programs and sets uniform standards for children in family day care homes and centers regardless of the state in which they are located.

The quality as well of the availability of child care is seriously undermined by the low salaries offered in child care. Child care providers today are paid less per hour than bartenders or parking lot attendants. Low wages mean high turnover in the child care profession -- a problem that exacts a high cost from our children. Children must worry whether their teacher will be there from one day to the next. Programs across the country are reporting that they are shutting down classrooms because they cannot find teachers or are doubling up and forcing a single caregiver to care for very large groups of children.

Availability of Care: Parents in communities all across the country know it is extremely difficult to find good quality care for their children while they are at work. Parents of infants and toddlers face the most difficult task. The demand for infant care is extraordinary because of the large influx of new mothers into the workforce and because infants require more frequent attention and care than older children.

Our employment policies have not kept pace with the changing realities of our workforce. With the exception of South Africa, the United States is the only other western industrialized nation that does not have a parental leave policy that allows parents to stay home with their new babies. As a result, most low income mothers must return to work and seek care for very young infants. Nearly half of the women who went back to work four to seven months after childbirth faced significant problems finding child care, according to a 1987 study conducted by the National Council of Jewish Women.

In many parts of the country, parents are competing for a place on a waiting list. At a child care center in Louisville, Kentucky, 96 youngsters younger than two are among the 130 children on the waiting list for the center's 80 child care slots. The average wait is nine months to a year. At the Somerset, New Jersey, Kinder-Care Center there are 150 children on the waiting list for the eight cribs in the infant room.

Some argue that waiting lists are not evidence of a supply problem because parents manage to find child care elsewhere. However, we have no way of knowing what care they are settling for while their names remain on waiting lists for quality programs.

Although more programs are available for preschoolers than for infants, many for three-and four-year olds are run on a part-day basis. Since most parents do not work part-time, bewildered youngsters must shuttle among as many as three care-giving situations in a single day.

The dearth of before- and after-school care for older youngster forces million to the streets and playgrounds or to a lonely and empty home. In 1984, when children were invited by the language arts magazine Sprint to write about a situation they find scary, the editors were stunned by the response. Nearly 70 percent of the 7,000 letters that poured in from across the country described fears of being home alone, mostly while parents were working.

The supply problem obviously is most acute for working poor families. The number of for-profit child care chains has grown very rapidly across the country. They are careful to locate in areas with a relatively high median income to insure that families can afford their services. They are not eager to offer their services in low income areas. Few states have made grant and loan programs available to help to start nonprofit child care centers. As a result, it is the children of the working poor who are most often left home alone or in inadequate or unsafe child care.

Consequences are Grim: The lack of decent and affordable child care is exacting a heavy toll on parents, children, and our competitive status as a nation. The millions of American children who will spend a significant part of their childhood in child care are vital to the nation's future economic health and competitiveness. Demographic changes are making it all the more crucial that every youngster get off to a strong start. Young people (between the ages of 16 and 24) made up 27 percent of the working-age population in 1978. By contrast in 2005 when today's four- and five-year-olds are in their early twenties, 16 to 24 year-olds will account for only 20 percent of the working-age population.

If we continue to neglect the child care and early childhood development of millions of poor children, we imperil not only their future, but our own. This is especially unfortunate when study after study reveals that high quality, comprehensive early childhood development programs lay the foundation for the basic skills that our children must have for success in school and later at work. These programs are even more crucial for disadvantaged children, and can help them to overcome some of the harmful effects of poverty.

Yet far too many children are denied good child care, often times with tragic consequences. Three parents recently testified before a Senate Committee and urged Congress to pass child care legislation that assures parents access to good quality child care.

- Jane Snead spoke about her only daughter, 10-month old Ashley who died in an unlicensed family day care provider's home from a massive dose of imipramine poisoning.

- Linda Hartshorn talked about Daniel, adopted after years of waiting. Danny died at twenty-one months from a large skull fracture. His babysitter has been indicted on three counts of child abuse as well as manslaughter.

- Cheri Robertson spoke about her son who was ten and one-half months-old when he was shaken by his family day care provider hard enough to equal his falling off a two story building landing on concrete. He survived, partially blind and paralyzed.

The lack of decent and affordable child care poses additional barriers to the self-sufficiency of low income families. In the only Census Bureau survey to compile such data, over 25 percent of unemployed mothers with preschool-age children said they would look for work if satisfactory child care were available at a reasonable cost. If those results were applied to the number of mothers of preschoolers today, over 1.6 million women who are currently unemployed would look for work.

The quality and availability of care is a constant worry for millions of working parents and drains their productivity. Focus groups of employed parents indicate the concerns that they bring to their jobs:

> "There's a whole dimension of pressure and fear that working parents carry around when our children are not well taken care of."
>
> "Child care problems can affect your productivity. You don't get your best work out of people who can't concentrate son what they're doing."

Employers increasingly understand as well that our inadequate child care system affects the productivity of our workforce and our nation's ability to compete. In 1986, a Fortune magazine study concluded that difficulty finding child care was one of the most significant predictors of absenteeism among employees with children younger than twelve. Employees with child care that broke down more frequently were also more likely to spend more unproductive time at work. A 1987 Census Bureau study reported that one in twenty working parents was absent from the job in the month prior to the study because of child care problems.

An Appropriate Policy Response to Child Care

A child care crisis confronts this nation. It grows more serious every day and will only intensify until our nation addresses it with the rationality and urgency it requires. It is heartening that the Administration and Congress appear to have finally recognized that federal child care legislation must be enacted this year. We urge you to recognize as well that such legislation must effectively respond to the overwhelming problems of cost, quality and availability that face working parents every day.

CDF believes that first and foremost, national child care legislation must ensure the protection, safety and development of our children, especially our poorest children. Second, child care policies must provide parents with a variety of real choices for the care of their children. In order to protect our children and make parental choice a reality not a slogan, federal child care legislation must:

- Help low income working parents pay the full cost of care and;
- Improve the quality of care and assure parents that publicly-funded child care is basically safe, healthy and of decent quality.

Tax Credits: Numerous tax credit proposals have been advanced in response to our nation's growing concerns about child care. While tax credits can be an extremely effective income support mechanism, they do not address the major child care problems facing working parents and their children. Standing alone, tax credits are not an effective child care policy.

Tax credits, and the Earned Income Tax Credit (EITC) in particular, are an effective income support policy and they have provided low income working families and their children with vitally needed additional income. We strongly support the expansion of the EITC and its adjustment for family size, and would welcome other tax credits directed to low income children and families. Many western industrialized countries have utilized tax credits to improve the economic well-being of children and families. Various forms of child allowances have been used to reduce child poverty and to supplement the earnings of low-wage families. No country, however, utilizes a child allowance or tax credit as a child care policy or program.

Tax credits do not ensure that the lowest income families can pay the cost of decent child care. As a result -- and despite the claims of their proponents -- tax credits do not expand parental choice of care. The following chart outlines the extremely limited utility of tax credits to enhance parental choice.

Parental Choice and Child Care
ABC Versus the Tax-Credit Approach

Factors Affecting Parental Choice	ABC	Tax Credit
Funds go directly to families for all forms of care (including church-based)	YES	YES
Sets minimum national standards (including parental involvement) to help parents measure and improve program quality	YES	NO
Parents have right to help set child care standards and policies on national, state, and local levels	YES	NO
Providers must ensure unlimited parental access to children during the day	YES	NO
Provides funds to increase the supply and variety of care, thereby expanding parental options	YES	NO
Assures services for parents working odd-hours and for children with special needs	YES	NO
Can pay full cost of care for very low-income families	YES	NO
Provides funds for school-age children	YES	NO
Funds resource and referral programs to educate parents about child care options and choices	YES	NO
Establishes consumer education programs on licensing and complaint procedures	YES	NO
Requires public hearings and opportunity for comments on services in each state	YES	NO
Requires states to record and make available substantiated parental complaints	YES	NO

Source: Senate Labor and Human Services Committee, Subcommittee on Children, Families, Drugs and Alcoholism

Tax credits also do not address the quality of care. They neither improve the substandard care too frequently available, nor do they provide parents with any assurances that their children will be safe and protected while they are at work.

Furthermore, tax credits do not address the problem of availability and supply. For example, the Dependent Care Tax Credit has been in place for many years, yet our child care crisis continues to grow, particularly among the working poor.

The tax credit proposal sponsored by President Bush, "The Working Family Child Care Assistance Act of 1989," is unfortunately not a child care proposal at all. It would do little or nothing to ease the frustrations most employed parents face as they search for safe and good child care at a price they can afford. It is a family income supplement, but an extremely modest one limited to small number of very poor families.

The new tax credit proposed by President Bush is limited to families earning less than $13,000 a year and with children under age four -- whether or not the family has child care expenses. The amount of the credit is determined on a formula basis, with the maximum credit of $1,000 per child available to families earning between $7,140 and $8,000. A smaller credit would be provided to other eligible families.

The President's new tax credit would not provide enough money to give poor families real choices in finding decent care for even their youngest children. For example, family day care in major cities usually costs $75 a week or more for the care of children 0 to 3. The new tax credit would provide $12 a week ($600 a year) to families earning $10,000 a year, while a family earning $12,000 a year would receive a credit of $3.85 per week ($200 a year) for the care of their infant or toddler.

The President's new tax credit plan would also give more new tax relief to families without out-of-pocket child care costs, and it imposes extraordinarily high marginal tax rates on poor and near poor families. We are providing you with an analysis of the marginal tax rates imposed by the new tax credit. It indicates that in 1990, the marginal tax rates for families with $11,000 income under the Bush tax credit proposals would increase to :

Families with 1 Child :	37.65 percent
Families with 2 Children:	57.65 percent
Families with 3 Children:	77.65 percent
Families with 4 Children:	97.65 percent

The President's new tax credit proposal simply does not respond to the urgent child care needs of everyday working parents and their children. Just as everything that glitters is not gold, everything President Bush calls a choice is not a choice.

The tax credit proposals included in the Chairman's Employment Incentives Act will provide vitally needed additional income for millions of low income working families with children. We strongly support its expansion of the Earned Income Tax Credit (EITC) and its adjustment for family size, as well as its provisions to improve the Dependent Care Tax Credit.

We are especially pleased that the Chairman's tax credit initiatives will extend to a broader range of low income working families than proposed by the President, and provide greater income support for families working outside the home. It is also important that otherwise eligible families would be able to utilize both the expanded EITC and the improved Dependent Care Tax Credit.

The Chairman's proposal to increase the Title XX Social Service Block Grant by $600 million will restore this important program to its scheduled level prior to the massive cutback it received in 1981. This program is used by the states to fund a broad range of children and human services. As you know, the demand for these services has increased substantially without a commensurate increase in Title XX funding.

Most important, we applaud the Chairman's simultaneous endorsement of the Act for Better Child Care Services and his explicit recognition that the Employment Incentive Act is not a substitute for comprehensive child care legislation. For no matter how well structured and how generous, a tax credit will not assure low income working families safe and affordable care for their children nor will a simple increase in Title XX. Comprehensive child care legislation is required to do so.

Comprehensive Child Care Legislation: The Act for Better Child Care (ABC) has been carefully designed to address the major child care problems facing millions of low income working parents and their children -- cost, quality and availability. ABC takes the steps necessary to help low income working families find and

afford good quality care for their children while they are at work. Unlike tax credits, ABC takes steps to ensure the safety, protection, and development of America's children, especially children in poor working families. Unlike tax credits, ABC will provide sufficient assistance to low income parents to allow them to select quality care for their children and give them the variety of decent choices now available to more affluent parents.

ABC enhances the choices available to poor working families. It does not favor one type of care over another type, but rather makes accessible to the working poor relative care, family day care homes, group care homes, and child care centers operated by community organizations, schools, religious congregations, employers and for-profit providers.

ABC takes long overdue action to improve the quality of child care by establishing minimum health and safety protections for child care programs receiving public funds. ABC would also improve the quality of care through annual training and improved salaries for staff and strengthened state and parental monitoring of programs.

In addition, ABC would build upon existing efforts and improve them by establishing resources and referral and consumer education programs for parents, and providing grants and loans to child care programs.

Most important, ABC was developed with children in mind. It is the product of over a year's deliberation involving the expertise of Congressional offices and 115 organizations that have, for years, worked with and heard from families and children in every state. ABC is complicated because there are no quick fixes in child care but there are solutions. Tax credits can effectively address the income needs of children and families -- as Chairman Downey's proposal does. Comprehensive legislation is necessary, however, to address the child care needs of low income working families and children.

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CHILD CARE: KEY FACTS

Children, Families, and Working Parents

Over the past several decades, women, including mothers with young children, have been entering the work force in record numbers.

Facts About Working Mothers:

- In 1988, 51.6 million women made up 45 percent of the total labor force (U.S. Dept. of Labor, Bureau of Labor Statistics, Employment and Earnings, January, 1989).
- Over half (51.0 percent) of all mothers with infants younger than age two are in the work force; 56.7 percent of all mothers with preschool-age children and 64.7 percent of all mothers with children under 18 work outside the home (U.S. Bureau of Labor Statistics, unpublished data, March 1987).
- About a quarter of today's working mothers are the sole support for their children (Bureau of Labor Statistics, unpublished data, March 1988).

Facts About Children:

- Of the 21.7 million children in the United States under age six, 10.5 million have mothers who work outside the home. Of the 26.9 million children in the United States between the ages of six and 13, 15.7 million have mothers who work outside the home (Bureau of the Census, unpublished data, March 1987).
- 63.5 percent of the children under age 18 in families headed by women had mothers in the labor force (Bureau of Labor Statistics, unpublished data, March 1987).
- By 1995, two-thirds of all preschool children and four out of five school-age children will have mothers who work outside the home (Sandra L. Hofferth and Deborah Phillips, National Institute of Child Health and Human Development, Child Care in the United States, 1970 to 1995, September 1986).

Most Mothers Work Because They Must

More and more mothers are working primarily out of economic necessity as the proportion of families headed by single mothers increases and the economic status of two-parent families with children declines. Often a mother's paycheck is all that stands between her family and poverty.

- In 1986, the median income for all families with children was $29,222. The median annual income was $17,500 for young families (families headed by persons younger than 30) with children (Children's Defense Fund calculations based on Bureau of Labor Statistics data for 1986).

- In 1986, the median income was $13,647 for single-parent families with children (Bureau of Labor Statistics, unpublished data, March 1987).
- Almost two-thirds of all mothers in the work force are single, widowed, divorced, separated, or have husbands who earn less than $15,000 a year (U.S. Department of Labor, unpublished data, 1987).
- Wives contribute an average of about 30 percent to their family's total income, but wives of husbands who earn between $10,000 and $15,000 a year contribute over 40 percent (Bureau of the Census, Current Population Reports, Money Income of Households, Families and Persons in the U.S., Series P-60, No. 151, 1984).
- Women whose husbands have lower incomes are more likely to work outside the home than women whose husbands have higher incomes. The more the husband earns, the less likely the wife is to work outside the home (Bureau of the Census, Current Population Reports, Money Income of Household Families, and Persons in the United States: 1984, P-90. No. 151, Table 22, p.78).
- A 1983 New York Times poll reported that for "71 percent of mothers who work, the primary reason was not for something interesting to do but to support their families."

Child Care is a Key to Family Self-Sufficiency

Child care is an essential part of the solution to helping poor families become self-sufficient through work.

- In the only Census Bureau survey to compile such data, over 25 percent of unemployed mothers with preschool-age children said they would look for work if satisfactory child care were available at a reasonable cost (Bureau of the Census, Current Population Reports, Child Care Arrangements of Working Mothers: June 1982, Series P-23, No. 129).
- If those results were applied to the number of mothers of preschoolers today, over 1.6 million women who are currently unemployed would look for work (CDF calculations based on Bureau of the Census, Current Population Reports, June 1982).
- Two-thirds of the respondents to a 1986 survey of welfare recipients by the National Social Science and Law Center cited difficulties with child care arrangements as the primary problem in seeking and keeping jobs; 76 percent of the women surveyed who had given up job hunting cited child care problems as the reason.

The High Cost of Child Care

Unless mothers have access to free babysitting by relatives, their annual child care costs constitute one of the largest household budget items, comparable to housing and taxes ("Juggling Jobs and Babies: America's Child Care Challenge," Population Reference Bureau, February 1987, p. 10).

- One state, Florida, has a Title XX child care waiting list which in 1988 stood at about 30,000 families.
- Researchers at Columbia University have found inadequacies in the supply of care for infants and toddlers throughout the country. They also document a lack of all-day care for children ages three to five and after-school care for the early elementary grades (Sheila B. Kamerman and Alfred J. Kahn, Columbia University School of Social Work, Child Care: Facing the Hard Choice, 1987).
- Although the hospital industry has the largest number of work-site child care centers, a 1987 study of 129 of these centers showed that two out of every three babies whose parents applied were turned away. The centers were serving 12,336 children while 7,988 more were on waiting lists (survey, Children's Defense Fund, 1987).

The Response of the Private Sector

Private organizations and employers recognize the need for child care and are trying to help parents find good care.

- Churches are the single largest provider of child care in the United States, supplying about one-third of all center-based care (When Churches Mind the Children, National Council of the Churches of Christ, 1983).
- A 1987 survey of 178 local United Way organizations showed that $66.5 million had been invested by the United Way in child care programs that year (United Way annual distribution survey, 1987).
- Fewer than 4,000 out of about 6 million employers in the U.S. provide some kind of child care assistance to their employees (Ellen Wojahn, "Who's Minding the Kids?," Savvy, October, 1987).
- On-site child care centers have few openings and higher-paid employees tend to get preferential treatment (Fern Schumer Chapman, "Executive Guilt: Who's Taking Care of the Children?," Fortune, February 16, 1987).

The States' Role in Child Care

While most states have attempted to deal with the increasing demand for affordable child care, overall state spending for child care in real dollars remains roughly at 1981 levels. States depend upon federal Title XX Social Services Block Grant funds for a variety of social services programs, including child care. As a result, reductions in Title XX funds since 1981 have severely hindered state governments in their efforts to provide child care programs. (See State Child Care Fact Book, Children's Defense Fund, 1988.)

- States, on average, devote 18 percent of Title XX to child care programs.
- Only 20 states served more children in 1988 than in 1981. Twenty-three states served fewer children in 1988 than they did seven years ago.

The Federal Role in Child Care

Despite the massive increase of mothers in the labor force, and the growing need for child care, the federal government has provided no corresponding commitment to the child care needs of working parents.

- The major federal source of direct child care assistance for low-income working parents -- the Title XX Social Services Block Grant -- was cut by more than 20 percent in 1981 (State Child Care Fact Book, Children's Defense Fund, 1988).

- The Dependent Care Tax Credit provides virtually no reimbursement for the child care expenses of the lowest income working families with children. The credit provides other families with limited assistance

- In 1985, among the 8.4 million families using the credit (at a deduction value of more than $3.1 billion) only 22 percent reported adjusted gross incomes under $15,000.

(Figures prepared by the National Women's Law Center, December 1988, from Internal Revenue Service data from 1984-85 tax returns.)

Options for Federal Child Care Policy

A growing bipartisan consensus has developed in support of a major federal role in child care. As the new Congress and Administration address the child care problems of working families, numerous legislative proposals will be introduced and debated in the 101st Congress. Among the most prominent are the following:

- The Act for Better Child Care or ABC (H.R. 30, S. 5) is comprehensive legislation that would provide direct child care assistance to low- and moderate-income working parents and would improve the quality of child care services. ABC was introduced by Representatives Dale Kildee (D-MI) and Olympia Snowe (R-ME) in the House and Senators Christopher Dodd (D-CT) and Orrin Hatch (R-UT) in the Senate.
- The Bush Administration has endorsed legislation to provide tax credits to low-income working parents for the care of their young children.
- Another proposal (H.R. 3), introduced by Representative Augustus Hawkins (D-CA), addresses child care by building upon existing federal programs such as Head Start and Chapter 1.

- The median annual income of full-time child care workers in 1984 was $9,204 for those employed in educational and social services settings and $4,402 for family day care providers.
- Only about one-half of all child care workers receive health benefits.
- Fewer than one in five has a retirement plan.
- Staff turnover rates are about 42 percent a year in child care centers and 59 percent a year in family day care homes.

(Figures from "In Whose Hands? A Demographic Fact Sheet on Child Care Providers." National Association for the Education of Young Children, 1985.)

Does Good Child Care Make A Difference For Children?

High quality preschool and child care programs can provide children -- especially those from low-income families -- with the foundation they need to do better in school and lead more productive lives.

- Comparison studies between groups of low-income three- and four-year-olds showed that by age 19, the group that had attended a quality early childhood development program were more likely to be literate, employed, and enrolled in post-secondary education and were less likely to be school dropouts, dependent on welfare, or arrested for criminal activity or delinquincy than those who had not attended. (See Changed Lives: The Effects of the Perry Preschool Programs on Youths Through Age 19, High/Scope Press, Ypsilanti, Michigan and Evaluation of the New York State Experimental Prekindergarten Program. Final Report. New York State Education Department, Albany, New York.)
- One dollar of federal monies invested in preschool education returns about $6.00 in savings because of lower special education and welfare costs and higher worker productivity (Opportunities for Success: Cost Effective Programs for Children, House Select Committee on Children, Youth and Families, update, 1988).

On the other hand, poor quality child care or no child care at all can have devastating results.

- A Los Angeles study of children in child care between the ages of 18 months and three years found major ill effects resulting from high turnover among providers. The children studied whose day care providers changed several times demonstrated less self-control and less confidence than peers who had stable child care environments (Howes-Olenick Study, the University of California at Los Angeles, 1986).
- Dozens of children throughout the United States are abused, neglected, or killed each year by unsafe providers or die in household accidents when left alone by desperate parents (Marian Wright Edelman, President, Children's Defense Fund, testimony before the Committee on Education and Labor, U.S. House of Representatives, February 25, 1987).

- A majority of the more than 1,000 school teachers recently interviewed cited isolation and the lack of supervision after school as a major reason children have difficulty in school (Louis Harris and Associates for the Metropolitan Life Insurance Company, 1987).

Does Good Child Care Make a Difference for Worker Productivity?

More and more working parents are having trouble finding quality child care they can afford and are going to work worried about the adequacy of their child care arrangements.

- A Census Bureau study reported that one in 20 working parents was absent from work during the month prior to the study because of child care problems (U.S. Census Bureau, Current Population Reports, Who's Minding the Kids?, Series P-70, No. 9).
- The breakdown of child care arrangements is the most reliable predictor of absenteeism and unproductive work time among employees with young children (survey, Bank Street College of Education and the Gallup Organization for Fortune, February 16, 1987).
- In a recent study, 46 percent of the working women interviewed reported having problems arranging child care and experienced high levels of stress that "made it difficult for them to do their jobs" (Mothers in the Workplace, National Council of Jewish Women Center for the Child, 1987).

What About the Supply of Child Care?

Although the former Secretary of Labor Ann McLaughlin recently testified that there is "not an across-the-board availability crisis of national proportions," the experiences of parents, long waiting lists for affordable child care, and other studies paint a disturbing picture in countless communities.

- In a survey of employees with young children in three major New Jersey companies, 46 percent said that locating quality child care was a major concern and 48 percent said that having an adequate selection of child care was also a major problem (Child Care and Productivity, Resources for Child Care Management and Bank Street College, 1987).
- In a recent poll of American voters, 74 percent said it is difficult for working parents to find quality child care at affordable prices. Sixty-three percent said there weren't enough child care services to provide for current needs (Marttila & Kiley, Inc. for AFSCME and Children's Defense Fund, June 1988).
- In a 1986 survey, 230 public housing projects across the country with on-site child care centers reported combined waiting lists totaling 96,000 children (Philip Robins, Professor of Economics, University of Miami, testimony before the Select Committee on Children, Youth and Families, U.S. House of Representatives, March 10, 1987).

- In the winter of 1984-85, the median child care expenditure was $38 per week or $1,976 per year (U.S. Bureau of the Census, Current Population Reports, Who's Minding the Kids? Child Care Arrangements: Winter 1984-85, Series P-70, No. 9).

However, other estimates and surveys suggest that average child care costs are much higher. Care for infants and toddlers tends to be more expensive than care for preschoolers. Center-based care is typically more expensive than family day care. The least expensive programs are those serving school-age children, while an in-home caregiver who is unrelated to the child is the most expensive form of child care.

- Child care for children younger than three in major cities averages $325 per month ($3,900 a year) for family day care and $394 per month ($4,728 a year) for center-based care.
- For children ages three to five, child care averages $294 per month ($3,528 a year) for family day care and $308 per month ($3,696 a year) for center-based care.

(Survey by Dana Friedman, The Conference Board Research Bulletin, Corporate Financial Assistance for Child Care, no. 177. Figures updated by Deborah Phillips, University of Virginia, November 1985.)

Current Care Arrangements for Young Children

Working parents rely upon a variety of care arrangements for their children, depending on cost, availability, quality, and other factors. In some cases, children care for themselves or are cared for by siblings. Primary child care arrangements utilized by employed mothers for children under five in 1984-85 were extremely diverse:

- 2.3 million children (31 percent) were cared for in the child's home (primarily by a relative).
- 3.0 million children (37 percent) were cared for in another's home (primarily by a nonrelative).
- 1.8 million children (23 percent) were cared for in organized child care facilities (group care, nursery schools, preschools).

(Figures from Bureau of the Census, Current Population Reports, Who's Minding the Kids? Winter 1984-85, Series P-70, No. 9.)

- Of about 17 million children ages five to 13 whose mothers were in the labor force, 1.8 million (11 percent) went unsupervised by an adult after school (Bureau of the Census, Current Population Reports, After-School Care of School-Age Children: December 1984, Series P-23, No. 149).

Trends in Types of Child Care

Group care, particularly in centers and preschools, has expanded rapidly over the past two decades, particularly among more affluent families. Although relatives of working mothers still provide care for about 24 percent of young children (under age five) needing child care, more and more grandparents and

other relatives today are either in the work force themselves or live hundreds of miles away. For children in child care:

- The proportion of young children cared for in day care centers and preschools rose from 6 percent in 1965 to over 23 percent in 1985.
- The proportion cared for in family day care homes grew from 16 to 22 percent during the same period.
- From 1965 to 1985, the proportion cared for by relatives declined from 62 to 48 percent, and the proportion of young children cared for by sitters dropped from 15 to 6 percent.

(Figures from Sandra L. Hofferth of the Urban Institute, testimony before the Select Committee on Children, Youth, and Families, U.S. House of Representatives, July 1, 1987.)

Current Child Care Options: How Good Are They?

Child development experts agree on the key factors that determine quality child care: small group size for adequate adult supervision; continuity of care for stability in a child's daily routine; staff with specialized training to deal with emergencies and stress; cooperation between caregivers and parents; and activities geared to a child's age that encourage optimal development and a safe physical environment. (See Deborah A. Phillips, Assistant Professor of Psychology, University of Virginia, testimony before the Subcommittee on Children, Families, Drugs, and Alcoholism, U.S. Senate, June 28, 1988 and National Day Care Study, U.S. Department of Health, Education and Welfare, 1979.)

However, the quality of child care varies widely from state to state and from provider to provider, and is often so inadequate that it threatens the well-being of the children served.

- Eleven states permit five or more babies to be cared for in family day care homes by one person without an assistant.
- Twenty-seven states do not guarantee a parent's right to drop in unannounced at their child's child care center. Thirty-five states do not guarantee unlimited access to their child's family day care home.
- Seventeen states do not require continuing training for teachers while they are employed in child care centers. Twenty-seven states require neither experience nor any form of training for family day care providers.

(Gwen Morgan, The National State of Child Care Regulation, 1986, Work/Family Directions, Inc., 1987. Figures updated by Children's Defense Fund, 1988).

Low Salaries Contribute to Poor Quality

More than 2 million people, most of them women, are employed in the care of our children. In 1984, two out of every three earned less than poverty-level wages regardless of their experience, training, or education.

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BUSH CHILD CREDIT TAX PLAN FAILS TO HELP FAMILIES WITH CHILD CARE COSTS AND CREATES ASTRONOMICAL MARGINAL TAX RATES FOR THE POOR AND NEAR-POOR

"The Administration is committed to lower marginal tax rates that provide incentives to saving, investment and work." Bush Administration Budget Message, 2/9/89, proposing cut in capital gains tax rate to 15 percent for wealthy Americans.

Marginal tax rates are the percentage of added income a family loses to IRS. Under the new Bush tax credit proposal for poor and near-poor families announced 3/15/89, marginal federal tax rates for families with $11,000 earnings in 1990 will be raised from 17.65% to:

37.65% for Families with 1 Child
57.65% for Families with 2 Children
77.65% for Families with 3 Children
97.65% for Families with 4 Children

A Children's Defense Fund Study

March 17, 1989

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Bush Child Credit Tax Plan Fails To Help Families With Child Care Costs And Creates Astronomical Marginal Tax Rates For The Poor And Near-Poor

I. Introduction

On March 15th the Bush Administration officially unveiled its plan for a children's tax credit. The Administration calls it a child care proposal. It is nothing of the sort. Its main beneficiaries will be families which have no child care costs.

The proposal would make "refundable" the existing dependent care tax credit. That is a credit equal to a portion (30 percent for lower income families) of a family's child care expenses. The maximum credit is $720 for one child and $1,440 for two or more. Families cannot receive a refund, however, if the value of the credit exceeds the taxes they otherwise owe. The President's refundability proposal means a family could get the value of the credit from IRS as a cash payment even if it had no other income taxes against which to offset the credit.

The President's other proposal would create a new tax credit and give families a choice between the new credit and the dependent care credit. The new credit also would be available only to working families. It would be worth, for each child under age four, 14 percent of the first $7,140 of family income (for a maximum of $1,000 per child). It would phase out between $8,000 and $13,000 family income in 1990, and at higher levels in later years. For example, at $12,000 income, the credit would be $200 per child in 1990. The new credit is available whether or not the family has any child care costs.

While expanded tax credits can provide much-needed additional income for low-income families, and such credits should be refundable, the Bush proposal does not address the major child care problems facing America's working parents and their children.

- The maximum credit of $1,000 per child would be available only to families in a very small income band -- those earning between $7,140 and $8,000 a year. Other eligible families would receive much less. While family day care costs families an average of $75 a week for children from birth to age three, the new Bush tax credit would give only $19.23/week to a family earning $7,500 a year, and $12 a week ($600 a year) to a family earning as little as $10,000. It would give only $3.85 a

week to a family earning $12,000. These amounts are not enough to give poor families real choices in finding decent care for their children.

- Families with children four or older would get no benefit from the new Bush credit. Lower-income families might benefit a little from the newly refundable dependent care credit, but low-income parents need far greater assistance for the care of their four-year-olds and school-age children than the limited assistance provided by the dependent care credit. Even if a family got the full $720 credit for one child, this comes to $13.85 per week.

- All parents need assistance finding child care, and they want assurances that their children will be safe while they work. Tax credits do not increase the options for or the quality of care that parents and children need and deserve.

II. <u>The Bush Plan Gives More New Tax Help to Families Which Have No Child Care Costs Than To Families Which Do Have Child Care Costs.</u>

Although the Bush Administration has tried to present its new credit as a "child care" proposal, the plan in fact will give, in most cases, considerably more help to those with no child care costs than to those with child care costs. It does so even though logic would dictate exactly the opposite -- that among families with the same income those who must pay for child care to generate that income have less ability to pay taxes than those who do not have to pay for child care.

The new credit will go to all low-income families with earned income, including those in which one parent does not work outside of the home and there are no child care costs at all. The credit is, in fact, not a "child care" proposal at all, but a children's credit. As a children's credit it is flawed as well, and its bias against families paying child care expenses makes it an anti-child care proposal.

Under the Bush plan, a family with child care expenses will get no more new help and typically will get less new help than a family with the same income and with no child care expenses. Because families must choose between the dependent care credit and the new credit, those families already using the dependent care credit will have no gain if the dependent care credit is larger and will have a smaller incremental gain than families with no child care if they switch from the dependent care credit to the Bush credit.

This effect will become particularly pronounced when the Bush plan fully phases in (in 1994) and is available to a larger number of moderate income families that can currently use the dependent care credit.

An example would be a family in 1994 with both parents working to make $17,000 and struggling to pay $1,500 to a day care provider for half-day care of their 3 year old. They can already get a $450 dependent care credit under current law. The Bush proposal offers them a $600 tax credit in 1994, but only if they forego their dependent care benefit. Their gain under the Bush plan is only $150. Their neighbors, however, with only one parent working outside of the home to make the same $17,000 and the other at home with the child, get a new $600 tax credit. Their gain from the Bush plan is four times as great. And they wind up considerably better off. Not counting Social Security and other Federal income taxes, which are the same for the two families, the family with child care expenses winds up with $16,100 net income ($17,000 plus $600 Bush tax credit minus $1,500 child care expenses), and the family without such expenses winds up with $17,600 net income ($17,000 earnings plus $600 Bush tax credit).

III. The Bush Plan Creates Astronomical Marginal Tax Rates for Poor Families

A marginal tax rate is the share of increases in its income that a family must pay in taxes -- the tax rate at the edge of the family's income. For example, if the tax rate is zero on the first $5,000 of income and 10 percent on the next $1,000, a family making $5,500 is in a 10 percent marginal tax bracket -- 10 cents of each additional dollar it makes go to taxes. It has a 10 percent marginal rate on added income even though its total average tax rate on the whole $5,500 is much lower than 10 percent (because the first $5,000 is tax-free).

Marginal rates matter because workers and investors make many economic decisions based on them. If an employee is told he can work overtime and raise his income from $10,000 to $12,000, but the marginal tax rate on the extra $2,000 is very high, that factor, rather than the tax on the first $10,000, affects his or her decision whether to and how much to work overtime.

The marginal tax rate a family must pay is the sum of the rate at which it must pay taxes on added income and the rate at which it loses tax credits because of added income. The Bush plan phases out credits at a rate of 20 percent per child. Because of this precipitous drop in value, the Bush plan imposes extraordinarily high marginal tax rates on poor

and near-poor families, when the taxes they must pay and the credits they will lose are combined. The larger the family, the bigger the loss. At the extreme, a family with four children under age 4 making $11,000 in 1990 would see 97.65 percent of any raise disappear and would pocket only 2.35 percent of the extra earnings. With $11,000 earnings, the family would get $2,527.40 in tax credits (from the Bush credit and the earned income tax credit), but pay $841.50 in Social Security taxes, leaving a net of $12,685.90. When their earnings rise to $12,000, their credits drop to $1,627.40 and their Social Security taxes rise to $918, leaving a net of $12,709.40.

Their $1,000 extra earnings have yielded only $23.50 for the year in extra net income after taxes. The other $976.50 (97.65 percent) is lost back to the federal government under the Bush plan. If the parent had to work overtime 4 hours a week for 50 weeks at $5/hour to generate the $1,000, his or her net pay for the overtime is about 12 cents an hour. The family's spending money has gone up 47 cents a week. And if the state and local income tax rate where the family lives exceeds 2.35 percent, the family loses even this 47 cents -- its marginal tax rate is over 100 percent and it loses more than $1 for each dollar of extra earnings.

This massive marginal tax rate is not some aberration for a particular family at a particular income level. Marginal rates for many "beneficiaries" of the Bush credit are very high because the Bush plan proposes a 20 percent reduction in the credit for each child when family income is between $8,000 and $13,000 (in 1990), and because that loss comes on top of the marginal tax rates already imposed by: the Social Security (FICA) tax (7.65 percent in 1990); the loss of the Earned Income Tax Credit (phased out at a 10 percent rate); state income tax rates; and (for some near-poor families) the 15 percent personal tax rate. Attachment A shows those rates in tabular forms: for each type of family (married couple or single parent), family size, and at each income level, it shows the marginal tax rates in 1990 under the Bush plan. Attachment B provides the same information graphically. But a quick snapshot of the extraordinary marginal rates under the Bush plan can be seen by looking at families at two income levels -- $8,000 and $12,000.

Marginal Tax Rate at $8,000 Income Under Bush Plan

Family with One Child	-	27.65%
Family with Two Children	-	47.65%
Family with Three Children	-	67.65%
Family with Four Children	-	87.65%

For these families the marginal rate indicated applies to all income between $8,000 and $10,740, except single parent families with one child would have an even higher marginal rate -- 42.65% between $9,050 and $10,740.

Marginal Tax Rate at $12,000 Income Under Bush Plan

Family with One Child	-	52.65%
Family with Two Children	-	57.65%
Family with Three Children	-	77.65%
Family with Four Children	-	97.65%

These rates apply to all incomes between $10,740 and $13,000, except: single-parent families with two children would have a marginal rate of 72.65% between $11,175 and $13,000; and married couples with one child would have a 37.65% rate from $10,740 to $11,825.

These marginal tax rates for the poor and near-poor are in marked contrast to the President's rationale for proposing lower rates on capital gains. The Administration's February 9th budget message to Congress said that President Bush wanted to lower the capital gains tax rate for the most well-off Americans from 28 or 33 percent to 15 percent because "The Administration is committed to lower marginal tax rates that provide incentives to saving, investment, and work." If the Administration believes that 28 or 33 percent rates are disincentives for the rich, its authorship of a proposal to put 58, 78, and 98 percent marginal rates on the poor and near-poor makes no sense at all.

While the Bush proposal in years after 1990 raises the point at which the phase-out of the credit occurs (in 1994 the phase-out range is $15,000-$20,000), that does not alter the proposal's imposition of astronomical marginal rates. It just changes the income levels at which such marginal rates occur. Indeed, it makes marginal rates for many moderate income families even higher because the 20 percent per child loss occurs in 1994 in the income range where the basic 15 percent income tax rate has already kicked in.

Such extraordinary marginal rates are not inevitable with low-income tax credits. Indeed, the existing Earned Income Tax Credit recapture rate is 10 percent and pending proposals to expand it and give a greater credit to families with more children still contemplate phase-out rates no higher than 20 percent for the whole family, not per child.

Marginal Tax Rates Under Bush Plan - Married Couple Families

1990 Income Above:	Number of Children	Current EITC Rate (Percent)	Federal Income Tax Rate (Percent)	Bush Child Credit Rate (Percent)	FICA Tax Rate (Pct.)	Cumulative Marginal Tax Rate (Percent)
0	1	-14.00	.00	-14.00	7.65	-20.35
6,810	1	.00	.00	-14.00	7.65	-6.35
7,143	1	.00	.00	.00	7.65	7.65
8,000	1	.00	.00	20.00	7.65	27.65
10,740	1	10.00	.00	20.00	7.65	37.65
11,825	1	10.00	15.00	20.00	7.65	52.65
13,000	1	10.00	15.00	.00	7.65	32.65
20,270	1	.00	15.00	.00	7.65	22.65
44,225	1	.00	28.00	.00	7.65	35.65
0	2	-14.00	.00	-28.00	7.65	-34.35
6,810	2	.00	.00	-28.00	7.65	-20.35
7,143	2	.00	.00	.00	7.65	7.65
8,000	2	.00	.00	40.00	7.65	47.65
10,740	2	10.00	.00	40.00	7.65	57.65
13,000	2	10.00	.00	.00	7.65	17.65
13,950	2	10.00	15.00	.00	7.65	32.65
20,270	2	.00	15.00	.00	7.65	22.65
46,350	2	.00	28.00	.00	7.65	35.65
0	3	-14.00	.00	-42.00	7.65	-48.35
6,810	3	.00	.00	-42.00	7.65	-34.35
7,143	3	.00	.00	.00	7.65	7.65
8,000	3	.00	.00	60.00	7.65	67.65
10,740	3	10.00	.00	60.00	7.65	77.65
13,000	3	10.00	.00	.00	7.65	17.65
16,075	3	10.00	15.00	.00	7.65	32.65
20,270	3	.00	15.00	.00	7.65	22.65
48,475	3	.00	28.00	.00	7.65	35.65
0	4	-14.00	.00	-56.00	7.65	-62.35
6,810	4	.00	.00	-56.00	7.65	-48.35
7,143	4	.00	.00	.00	7.65	7.65
8,000	4	.00	.00	80.00	7.65	87.65
10,740	4	10.00	.00	80.00	7.65	97.65
13,000	4	10.00	.00	.00	7.65	17.65
18,200	4	10.00	15.00	.00	7.65	32.65
20,270	4	.00	15.00	.00	7.65	22.65
50,600	4	.00	28.00	.00	7.65	35.65

Marginal Tax Rates Under Bush Plan - Married Couple Families

Attachment A

Marginal Tax Rates Under Current Law - Married Couple Families

1990 Income Above:	Number of Children	Current EITC Rate (Percent)	Federal Income Tax Rate (Percent)	Bush Child Credit Rate (Percent)	FICA Tax Rate (Pct.)	Cumulative Marginal Tax Rate (Percent)
0	1	-14.00	.00	.00	7.65	-6.35
6,810	1	.00	.00	.00	7.65	7.65
10,740	1	10.00	.00	.00	7.65	17.65
11,825	1	10.00	15.00	.00	7.65	32.65
20,270	1	.00	15.00	.00	7.65	22.65
44,225	1	.00	28.00	.00	7.65	35.65
0	2	-14.00	.00	.00	7.65	-6.35
6,810	2	.00	.00	.00	7.65	7.65
10,740	2	10.00	.00	.00	7.65	17.65
13,950	2	10.00	15.00	.00	7.65	32.65
20,270	2	.00	15.00	.00	7.65	22.65
46,350	2	.00	28.00	.00	7.65	35.65
0	3	-14.00	.00	.00	7.65	-6.35
6,810	3	.00	.00	.00	7.65	7.65
10,740	3	10.00	.00	.00	7.65	17.65
16,075	3	10.00	15.00	.00	7.65	32.65
20,270	3	.00	15.00	.00	7.65	22.65
48,475	3	.00	28.00	.00	7.65	35.65
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6,810	4	.00	.00	.00	7.65	7.65
10,740	4	10.00	.00	.00	7.65	17.65
18,200	4	10.00	15.00	.00	7.65	32.65
20,270	4	.00	15.00	.00	7.65	22.65
50,600	4	.00	28.00	.00	7.65	35.65

Marginal Tax Rates Under Current Law - Married Couple Families
Attachment A

Marginal Tax Rates Under Bush Plan - Single Parent Families

1990 Income Above:	Number of Children	Current EITC Rate (Percent)	Federal Income Tax Rate (Percent)	Bush Child Credit Rate (Percent)	FICA Tax Rate (Pct.)	Cumulative Marginal Tax Rate (Percent)
0	1	-14.00	.00	-14.00	7.65	-20.35
6,810	1	.00	.00	-14.00	7.65	-6.35
7,143	1	.00	.00	.00	7.65	7.65
8,000	1	.00	.00	20.00	7.65	27.65
9,050	1	.00	15.00	20.00	7.65	42.65
10,740	1	10.00	15.00	20.00	7.65	52.65
13,000	1	10.00	15.00	.00	7.65	32.65
20,270	1	.00	15.00	.00	7.65	22.65
35,050	1	.00	28.00	.00	7.65	35.65
0	2	-14.00	.00	-28.00	7.65	-34.35
6,810	2	.00	.00	-28.00	7.65	-20.35
7,143	2	.00	.00	.00	7.65	7.65
8,000	2	.00	.00	40.00	7.65	47.65
10,740	2	10.00	.00	40.00	7.65	57.65
11,175	2	10.00	15.00	40.00	7.65	72.65
13,000	2	10.00	15.00	.00	7.65	32.65
20,270	2	.00	15.00	.00	7.65	22.65
37,175	2	.00	28.00	.00	7.65	35.65
0	3	-14.00	.00	-42.00	7.65	-48.35
6,810	3	.00	.00	-42.00	7.65	-34.35
7,143	3	.00	.00	.00	7.65	7.65
8,000	3	.00	.00	60.00	7.65	67.65
10,740	3	10.00	.00	60.00	7.65	77.65
13,000	3	10.00	.00	.00	7.65	17.65
13,300	3	10.00	15.00	.00	7.65	32.65
20,270	3	.00	15.00	.00	7.65	22.65
39,300	3	.00	28.00	.00	7.65	35.65
0	4	-14.00	.00	-56.00	7.65	-62.35
6,810	4	.00	.00	-56.00	7.65	-48.35
7,143	4	.00	.00	.00	7.65	7.65
8,000	4	.00	.00	80.00	7.65	87.65
10,740	4	10.00	.00	80.00	7.65	97.65
13,000	4	10.00	.00	.00	7.65	17.65
15,425	4	10.00	15.00	.00	7.65	32.65
20,270	4	.00	15.00	.00	7.65	22.65
41,425	4	.00	28.00	.00	7.65	35.65

Marginal Tax Rates Under Bush Plan - Single Parent Families

Attachment A

Marginal Tax Rates Under Current Law - Single Parent Families

1990 Income Above:	Number of Children	Current EITC Rate (Percent)	Federal Income Tax Rate (Percent)	Bush Child Credit Rate (Percent)	FICA Tax Rate (Pct.)	Cumulative Marginal Tax Rate (Percent)
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10,740	1	10.00	15.00	.00	7.65	32.65
20,270	1	.00	15.00	.00	7.65	22.65
35,050	1	.00	28.00	.00	7.65	35.65
0	2	-14.00	.00	.00	7.65	-6.35
6,810	2	.00	.00	.00	7.65	7.65
10,740	2	10.00	.00	.00	7.65	17.65
11,175	2	10.00	15.00	.00	7.65	32.65
20,270	2	.00	15.00	.00	7.65	22.65
37,175	2	.00	28.00	.00	7.65	35.65
0	3	-14.00	.00	.00	7.65	-6.35
6,810	3	.00	.00	.00	7.65	7.65
10,740	3	10.00	.00	.00	7.65	17.65
13,300	3	10.00	15.00	.00	7.65	32.65
20,270	3	.00	15.00	.00	7.65	22.65
39,300	3	.00	28.00	.00	7.65	35.65
0	4	-14.00	.00	.00	7.65	-6.35
6,810	4	.00	.00	.00	7.65	7.65
10,740	4	10.00	.00	.00	7.65	17.65
15,425	4	10.00	15.00	.00	7.65	32.65
20,270	4	.00	15.00	.00	7.65	22.65
41,425	4	.00	28.00	.00	7.65	35.65

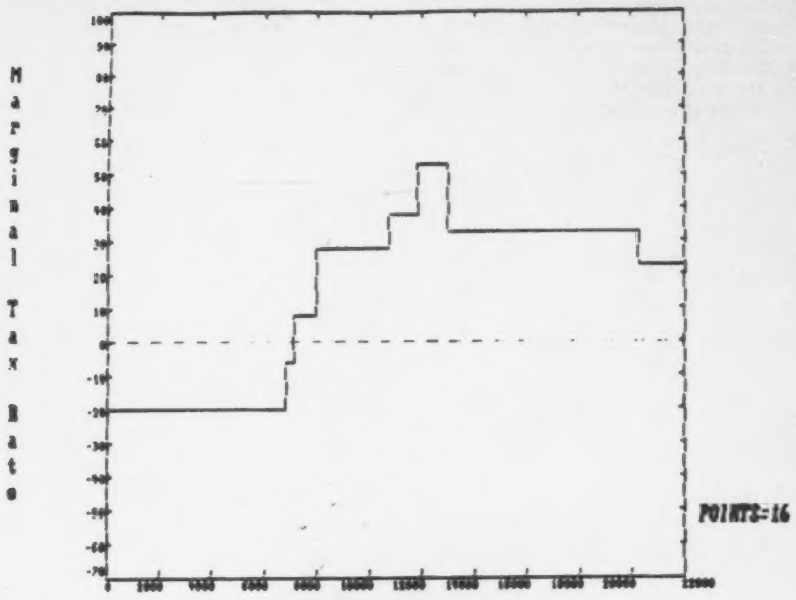
Marginal Tax Rates Under Current Law - Single Parent Families
Attachment A

Assumptions for 1990 Federal Tax Marginal Rate Computations:

	1988	1990
Married Couple Standard Deduction:	$ 5,000	$ 5,450
Household Head Standard Deduction:	$ 4,400	$ 4,800
Exemption Value:	$ 1,950	$ 2,125
Current Law EITC Maximum Earnings:	$ 6,225	$ 6,810
Current Law EITC Recapture Starts:	$ 9,850	$ 10,740
Current Law EITC Credit Rate :	- 14.00 %	- 14.00 %
Current Law EITC Recapture Rate :	10.00 %	10.00 %
Married Couple 28% Bracket Begins:	$ 29,750	$ 32,400
Household Head 28% Bracket Begins:	$ 23,900	$ 26,000

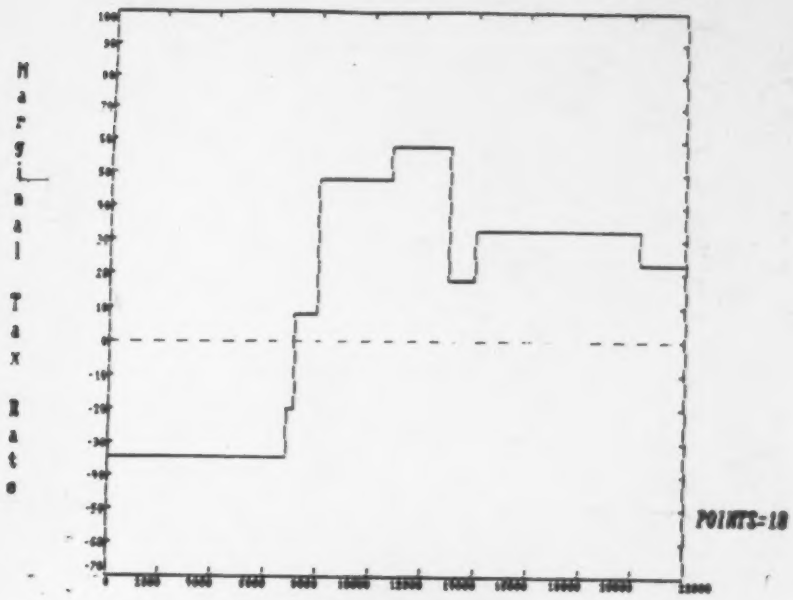
Attachment A

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



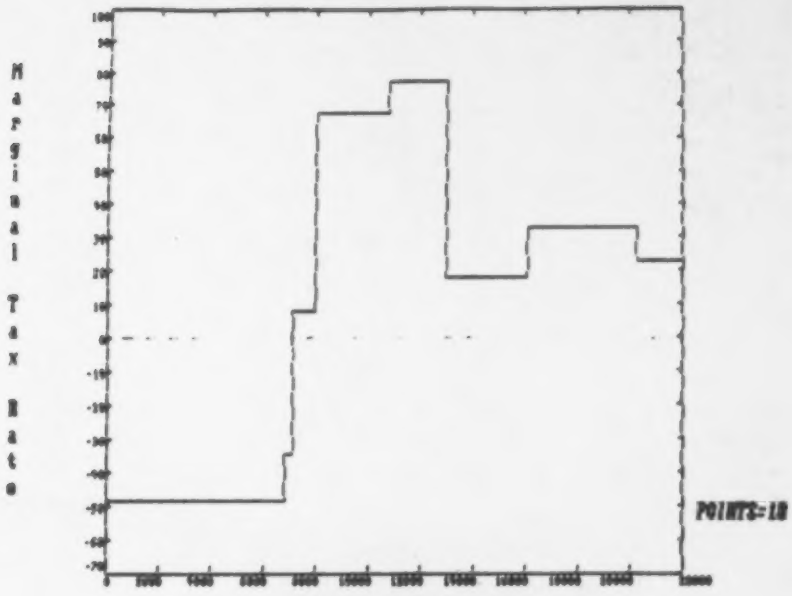
Attachment B

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



Attachment B

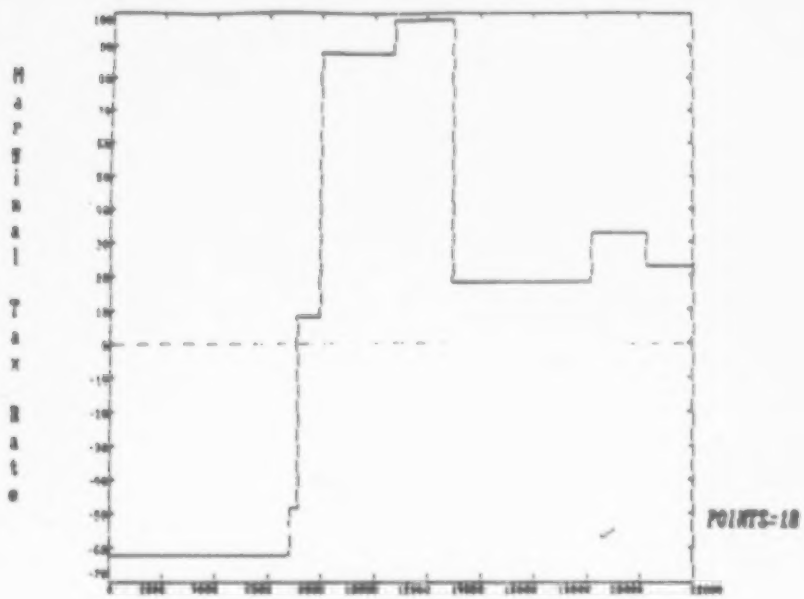
Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1998



1998 Gross Earnings
Married Couple with Three Children

Attachment B

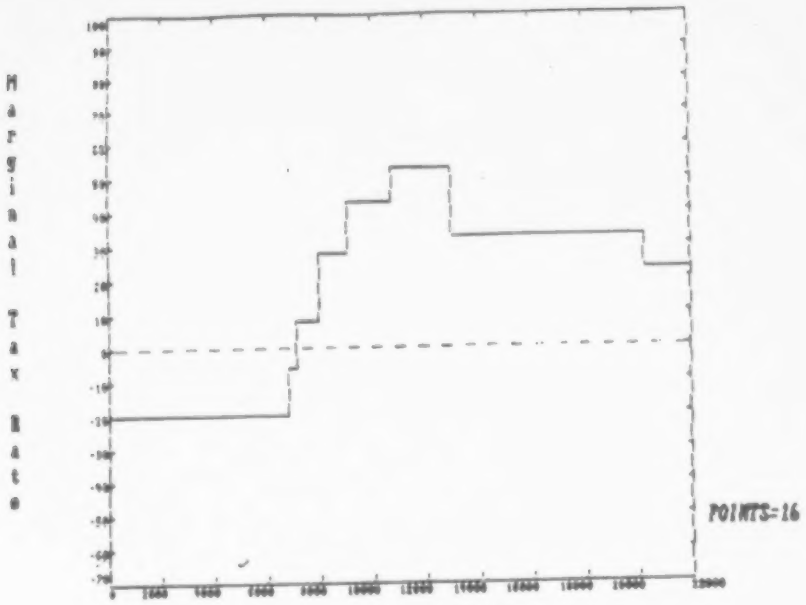
Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



1990 Gross Earnings
Married Couple with Four Children

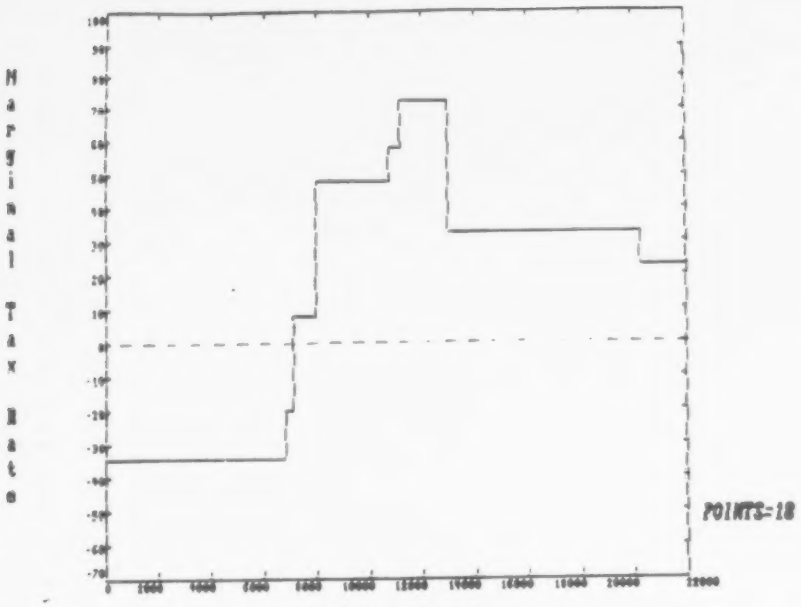
Attachment B

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



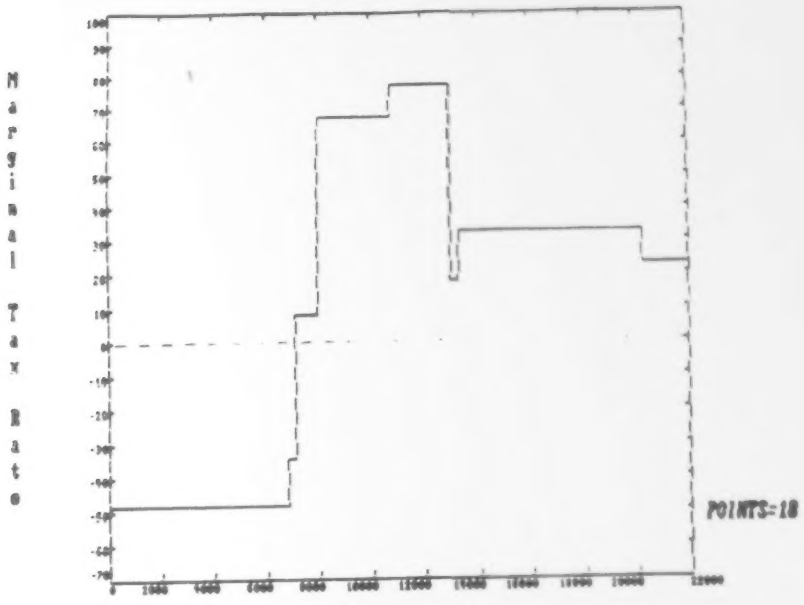
Attachment B

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



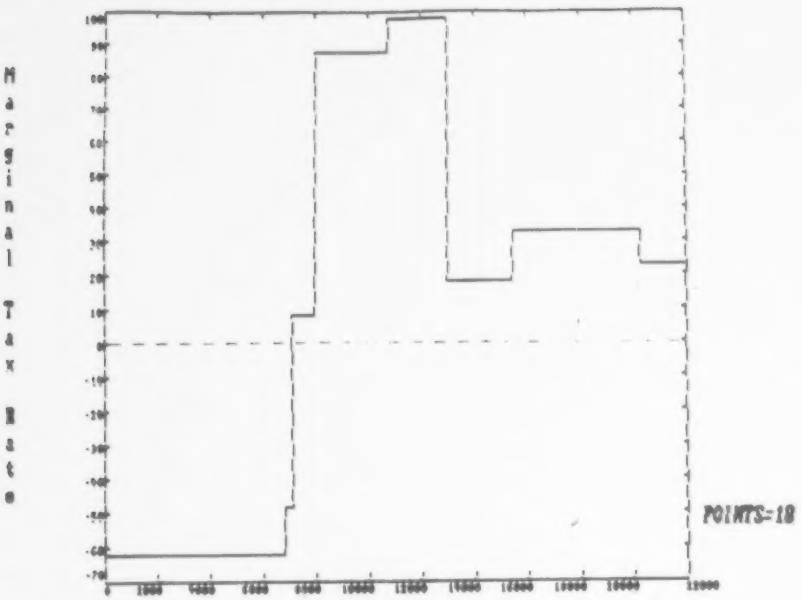
Attachment B

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1998



Attachment B

Marginal Tax Rates Created By
The Administration's Proposed
$1,000 Per Child Tax Credit
For Low-Income Families In 1990



Attachment B

Acting Chairman DOWNEY. Thank you.

Ms. Sawhill, let be begin by asking you, from your vantage point, poverty has been fairly persistent over the past two decades, and there are lots of different approaches that we have taken. If you were sitting up here in my spot, what else would you be doing and what else would you recommend that we look at, dealing with the whole question?

Ms. SAWHILL. Well, several things. First of all, I would give a high priority to increased funding for programs targeted on children that have a good track record of success, and by this I mean things like Head Start and WIC and compensatory education, and for older children or adolescents, programs like the Job Corps. I think we have enough experience with these programs to know that they prevent the persistence of poverty by giving children a chance to move out of the circumstances that produce poverty.

In the work that I did with The American Agenda last summer, we put a great deal of emphasis on the need to help poor children. I am glad that Marian Wright Edelman is here because her organization has done similar work and come up with similar proposals; but I think it is noteworthy that The American Agenda, as a bipartisan group, got behind the need to invest as much as an additional $2 billion a year in these programs of proven effectiveness for children. Both former Presidents Ford and Carter signed on to that set of proposals.

A second thing I would want to worry about is the adequacy of support for education and training for welfare mothers, as part of the Family Support Act and as part of the Job Training Partnership Act. I realize not all of this comes within your jurisdiction, but I do think that it is very important to increase support for training, and we have not been doing that.

The implicit proposals of the Bush Administration in this area are to actually reduce funding for employment and training assistance, and I am very concerned about that. We are not going to get welfare mothers moved into the work force if we don't adequately fund those efforts.

Acting Chairman DOWNEY. Can I ask you, in putting together, as we did, the EITC proposal, I was concerned that we weren't doing enough for childless couples and for working poor people who don't qualify for EITC but who may need it just as much. You made a recommendation for providing the EITC to fathers who are paying child support, which is something that we will look at as an expansion. I take it your only reason for not wanting to expand it further is simply a question of resources.

Ms. SAWHILL. It is largely that, plus the difficulty, the practical difficulty of distinguishing single individuals who really have entered their primary adult occupation and those that are still combining work with school or other activities and may still be partially dependent on their parents. If I was going to extend the EITC to unrelated individuals or families without children, I think I would maybe want to have an age condition on the eligibility.

Acting Chairman DOWNEY. Doesn't Mr. Bauer make an interesting point that we have to consider, that if you are poor and you choose to leave your child with informal care, shouldn't we somehow recognize this? I buy the argument because I think it is axio-

matic and obvious that families have different income, as you pointed out, and some can afford to have informal care and can afford to stay home. Others have to send their children out, and they need both quality care and the money to get that care. But at a certain income level, doesn't Mr. Bauer make a point that we have to consider here, and that is that maybe for that lower income—and maybe we can agree on where the lower income is—we want to provide some additional money for the person who decides to have this informal arrangement?

Would you address that?

Ms. SAWHILL. Yes. I have some sympathy with that point, also. It seems to me we don't want to discourage informal care arrangements. They are what work for parents. They are what parents are choosing, and they may in many cases be good solutions to the problem.

That would lead me to want to at least think about providing some kind of a work expenses deduction or credit which was generalized and did not depend upon the actual amount of outlays for child care, so that if a working poor family has been particularly clever in the way they have arranged their child care, they are not in any way penalized. At the same time, their working is recognized because they do get an extra credit associated with the fact that they have work-related expenses, but we don't vary it with the amount of actual outlays.

Acting Chairman DOWNEY. Marian, what is your view of that?

Mrs. EDELMAN. I am for supporting as many choices for families as possible, and under ABC one is able to do this. Relatives are eligible for funding.

Acting Chairman DOWNEY. Mr. Bauer, first of all, I welcome your support. It is approbation indeed to have you support at least part of the proposal put forward by me, Mr. Petri and others. I sense consensus or the elements of a consensus. I make no bones about the fact that I support ABC too, happily, and I think it is essential that we do both, but I am interested in your ideas and want to ask you a couple of questions about your proposal.

If in fact I can manage to get Marian and Isabel and others to agree with this proposal, what sort of income limit are we talking about for recognizing informal day care arrangements under the Tax Code, for a family that decides to stay home?

Mr. BAUER. Mr. Chairman, I am not used to reaching consensus this early in a hearing, so I am not sure that I can——

Acting Chairman DOWNEY. Well, we are not there yet, believe me.

Mr. BAUER [continuing]. Give you a specific income level, but my staff is working on the idea, and I certainly think it is within the possibility for reasonable men and women to agree, broadly speaking, on some level that would be acceptable and that would recognize the obvious fiscal restraints that we all have to deal with.

Acting Chairman DOWNEY. Are you concerned about this question of family size and family age really making the whole system vastly more complex than I think we want it to be?

Mr. BAUER. Well, you know, I learned in 8 years in Government that this city is full of unintended consequences, and one of them is that our best efforts inadvertently often do make things more com-

plex for the average person out there who is dealing with the forms and so forth, but again, I do not think it is beyond the reach of intelligent men and women to come up with ways that even the average American taxpayer can deal with and get a benefit.

Acting Chairman DOWNEY. Let me ask you, Ms. Edelman makes a point, and has to the Congress and to me and others, that is very persuasive. That is that while we want to vest people with choice, that it is essential that at the same time, that choice be a good one; that is that if people can't find informal arrangements and have to resort to more formal arrangements, that there need to be standards.

You make the distinction between a Government program that is funded and one, like a tax credit, that isn't. Many of us, for budget purposes, don't make that distinction. We see tax credit as a loss of revenue that we have to account for in the scorekeeping and in the budget process, so it is real revenue to us.

What is wrong with the idea that, if the Federal Government is going to see some of this income lost—obviously it is not ours to begin with, I guess you would make that argument, but let's assume for the moment that it is revenue that we have to account for somehow, that it is a Federal program—that there should be some standards, national standards, that accompany it?

While I am frankly completely prepared to allow States to do the work, I am worried that some of the States won't do the work, and that the children in Alabama or Mississippi or Louisiana—and I am not singling them out—but if those States decide not to do as good a job protecting their children, that worries me, because these are American children.

Mr. BAUER. Right. Well, Mr. Chairman, I am afraid I have a healthy skepticism about the ability of regulations in Washington to solve these kinds of problems. One can look, just in recent months, at the whole nursing home area where we have had several recent reports that show, in spite of years of regulation, we still have a situation where there is a certain degree of abuse in American nursing homes. I suspect that in the course of that regulation, the Government has been at least partly responsible in driving up the incredible costs that families now face when they have a nursing home decision to make.

The interesting thing is that when you talk to folks from Alabama and Louisiana who may support the idea of national standards, they will cite New York as the State they are worried about. I am not sure what State out there is going to be irresponsible about regulations that protect their own children. Quite frankly, I have a lot of confidence in State and local officials being able to do an effective job of that, even in Louisiana and Mississippi.

Acting Chairman DOWNEY. Yes, and it is unfair to just single them out because, as you correctly point out, my State has lots of problems. We don't even know where many of the foster care children in my State are from one day to the next, and so we have much to be concerned about, as well.

But isn't it a bit too glib to simply say that because some regulations haven't worked, that we should ignore the possibility that others might work?

Mr. BAUER. I would try to be a little less glib than that and say that, since other regulations haven't worked, we ought to keep that in mind before we go off on the same path again, thinking that it is going to pay us great dividends or solve the problem.

Acting Chairman DOWNEY. But you see—and it seems to me evident from your testimony—that this Government needs to do something for the bottom 20 percent of the people who want to work, we should be making it easier for people to work and raise their families and provide for their children, and that the Government has an important role to play in doing that?

Mr. BAUER. I believe, even perhaps more broadly than that, that the one overwhelming fact since the end of World War II is that families with children, particularly lower income and lower working class people but generally families with children, are facing greater burdens today financially, are facing greater tax burdens than they did 40 years ago. I think that it represents good public policy, any time Government can do anything to help those folks keep more of what they make, so that they can make their own choices about where to spend it and how to spend it on those children.

Acting Chairman DOWNEY. Marian, how do we answer the argument that Mr. Bauer and others will make about this point that we are empowering people with choice, and inevitably the question of standards will make the choice more expensive, and, possibly, may preclude people from having that choice in some instances?

Mrs. EDELMAN. Well, I think that I would like Helen to address how much more expensive standards have been, but again I would like to rely on what parents say they would like to have in terms of choice for their children. Parents overwhelmingly, in two polls conducted last year—one by NBC and the Wall Street Journal—69 percent of them strongly back such standards. CDF and AFSCME did another study, and 75 percent of the American public, especially women, strongly supported national standards.

The private sector is increasingly recognizing the importance of Federal standards. American Express strongly testified in favor of national child care standards, because the patchwork of State standards is negatively affecting the mobility of their work force. CIGNA came in with similarly strong testimony in favor of standards, and thought that the cost of child care insurance would be reduced if we had in force some standards which could provide earlier protection for children. And if the Army and the military think standards are good for their employees' children, I think that standards should well serve us for our civilian children as well, because I think there are certain minimal levels of safety.

While every set of standards that the Federal Government has enacted hasn't worked perfectly, they also haven't been enforced perfectly. The answer, it seems to me, is better enforcement and that we need to take extra care to ensure that those parents who are the least able to protest can be assured of some minimal protections of quality.

Now I don't know what Helen would say about the cost of child care standards. I think that we have not seen very strong studies, but it is not our view that having minimal safety standards has

greatly increased the cost of administering child care or decreased the choice of parents, but maybe you can address that.

Ms. BLANK. I think if you are putting money in public programs, you want some minimal quality even if it costs a little bit more.

The Army didn't look simply at costs. When the Army looked at the kind of child care they wanted their children to be in, they found that State standards didn't give them sufficient protection. So when they have a child care program in Mississippi, it has the same standards as New York because they were uncomfortable with using State standards.

Arizona improved its standards, and the Auditor General in that State found the child care cost $5 more a week, but I don't know if we should let cost be the driving issue. The ABC bill does not impose standards on families who don't receive public funds, and if we have to serve a few less children but we know that they are in safe child care, I think that is the issue that should concern us.

I don't find that all States provide an adequate floor. For example, 11 States allow one provider to care for 10 children, several of them infants, in family day care, and that is just not good for young babies. We are talking about a minimal floor, and if there is a cost differential, I think that is a perfectly appropriate role for the Federal Government.

Acting Chairman DOWNEY. Mr. Bauer?

Mr. BAUER. If I may, Mr. Chairman, I must say that the one area where I find myself somewhat tempted in this area is in the question of health or disease issues, which I think we can certainly make a reasonable case about. You are probably aware of the increasing amount of research that shows significant health problems in day care centers with more than 12 or 15 infants in them.

My understanding is that some new research that will probably come out in the next month or so indicates that serious diseases like hepatitis and meningitis, et cetera, that children in larger day care centers run a much greater risk of exposure to and catching those diseases. If the Federal Government is going to go down this road, I think one could make a case that, particularly with large centers, consumers should see that information, that it should be posted in some way, or somehow understand what risks do exist with the larger centers.

Acting Chairman DOWNEY. Let me ask you one last question: How do you respond to this point that the Army, for instance, has standards, and in a way that means we already have national standards. It would be absurd in one instance for us to provide a different level of care for children who are being cared for under the auspices of the military than we would for civilian children.

Mr. BAUER. Well, I think relatively speaking we are talking about a fairly small percentage of all of America's children when we are talking about children with Army parents. I would think that from a public policy standpoint we would want to take a very close look before we take that experimental situation or that trial situation, and immediately make the jump and say that ought to apply across the board.

Again, I think there is a good deal of evidence that other regulatory efforts like this have not worked. Again, I am not sure what

State it is that is going to fail to take adequate efforts to protect its own children.

Acting Chairman DOWNEY. Of course, when we find the states that do, it will be little comfort to us after they have failed.

Mr. BAUER. But if they are failing, we shouldn't have to look too hard, and I don't know anybody that is saying, "Look at such-and-such a State. It obviously just does not care about its kids."

Acting Chairman DOWNEY. Well, what about the 11 States that were mentioned or cited as providing for a minimal level of care, one care provider to 10 or 11 children?

Mr. BAUER. Okay. I think the next step that you are going to have to take is whether or not the record of abuse is worse in those States than it is in highly regulated States, and the research that I have seen does not show a significant difference in reporting of abuse between highly regulated and fairly low regulated States.

Acting Chairman DOWNEY. Then you ask the question, do the highly regulated States have better instances of reporting than the States that aren't regulated, and then you would have to account for population size and a whole series of other——

Mr. BAUER. Absolutely. I can see that there are problems and many unanswered questions, but that to me is a prescription for slowing down rather than leaping into a nationwide regulatory approach.

Acting Chairman DOWNEY. Ms. Edelman, did you want to comment?

Mrs. EDELMAN. Well, I guess I want to just say one thing, that pushing for Federal standards in the context of ABC is not a new thing. This is not an experiment. We have experience with national standards.

When "Rosie the Riveter" went off to the war factories, and as the fathers went off to war, we had very stringent, detailed national standards during the war and during WPA days in federally-run centers, much more prescriptive and much more detailed than those we are attempting to put into play in ABC, so we have a history of guaranteeing quality care in federally-funded child care centers, arising out of WPA and the war days. We know what can happen, and I think that we give States 4 or 5 years to comply and bring their minimal health and safety standards into place.

I guess my own view about social policy, Mr. Bauer, is that I wouldn't want to place anybody else's child in a child care center that I wouldn't want to place my child. I do feel very strongly that if the quality of the care is not good for poor children, then that in the long term is not going to pay off in preparing them for school and giving them the strong early foundation I think they need. If we don't do it right, I am just afraid that it is not going to be fair to the children and it is not going to yield the longer term results that we want in terms of well-educated, self-sufficient young people.

Mrs. JOHNSON. Mr. Chairman, would you yield on this a moment? I am sorry that I have to leave, and I appreciate your allowing me to submit my statement for the record.

Acting Chairman DOWNEY. Without objection.

[The statement of Mrs. Johnson follows:]

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6TH DISTRICT, CONNECTICUT

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SUBCOMMITTEES
HEALTH
HUMAN RESOURCES

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OPENING STATEMENT OF THE HONORABLE NANCY L. JOHNSON
HUMAN RESOURCES SUBCOMMITTEE
COMMITTEE ON WAYS AND MEANS
MARCH 21, 1989

Mr. Chairman, I am delighted, as the newest member of the Subcommittee on Human Resources, to be sitting here on the dais as we begin our second in a series of hearings on how to help the working poor.

I have testfied before this Subcommittee on several occasions on the problems of the working poor. I believe that the question of how to assist these hard-working families in remaining independent and self-sufficient is one of the key policy challenges Congress faces. I commend your initiative.

This morning, I reintroduced with Sen. Orrin Hatch our Child Care Services Improvement Act of 1989. This bill lays out a comprehensive strategy to assist the working poor in continuing to work by addressing one important facet of employment: child care. It sets up a child care assistance plan that will be there for families today when they need it and provides a solid foundation for future policy development as resources allow.

The Child Care Services Improvement Act offers a number of strategies -- including grants and liability insurance reforms -- to expand the supply of child care and make quality child care more available and affordable to parents. But I would like to focus on what I believe is its best feature: it preserves families' freedom to make the choices that are best for them.

Like your Employment Incentives Act, Mr. Chairman, our bill expands the Earned Income Tax Credit and ties it to family size. This kind of a refundable tax credit is the cornerstone of any serious policy to help working families.

Families struggling at the margins are largely ignored by federal policy and often when we do notice them, we discriminate against them. For years affluent families have been able to take advantage of the Dependent Care Tax Credit. Government gives them the resources to buy child care and trusts them to do what is best for their kids. Poor families get "slots." If the waiting list is too long, the day care center inconvenient, the opening in a day care center when the parent wants a day care home or vice versa, then that family has no option. The implication is that poor families don't know what's best for their children and cannot be trusted to

to make choices for their children as current law entrusts more affluent parents.

Mr. Chairman, I call this to your attention because it is only one example of the way in which we tend to demean low-income families under the guise of helping them. It exemplifies a mistake we must not continue to make -- treating people unequally on the basis of income.

Any proposal designed to assist working families stay employed must address the fact that today's society is overwhelmingly composed of families in which both parents work or in which the only parent works. Bolstering strong, self-sufficient families means giving working parents the flexibility to meet both work and family responsibilities. Therefore, our bill contains incentives for employers to offer child care benefits and something more: a tax credit to encourage business to adopt policies that will enable employees to reduce their child care needs, by shifting work hours or working at home.

The demand reduction component is unique to our bill and is every bit as important as enabling parents to buy good day care. As Dr. Berry Brazelton says, parents being with children is not only important to the children's development, it is important to the maturation of the parents.

How we address the problems of the working poor is essential to our success. If we construct a rigid bureaucracy which forces working families to fit a mold in return for government assistance then we will not be helping them, now or in the future.

On the other hand, if we provide families with resources and flexibility to meet working parents' needs and the needs of their children, then we can create a plan that will work not only this year but will provide the framework for fostering strong families in years to come.

Working poor families are making it, but at great sacrifice and with little reward other than the satisfaction of being self-sufficient. They, as much as anyone, deserve our support.

Thank you, Mr. Chairman, for calling this hearing. I look forward to hearing from the witnesses this morning.

Mrs. JOHNSON. Ms. Edelman. I look forward to working with you on this issue. In regard to the national standards issue, I want to mention that under the ABC bill my State, which has had among the strictest standards in the Nation, would have been disqualified from any Federal aid every 1 of the last 3 years. This is true even though our standards would have been superior to almost any conceivable set of national standards that would have been established under the ABC bill.

Here's why. The ABC bill contained a provision that prohibited degradation of standards by any State. As a result, if a State with exceptionally high standards wanted to reduce one small provision, even if the new provisions were still above the standard set in the bill, that State would be denied funds.

Connecticut, by changing its staff-child ratio to allow one more latchkey kid in our family day care homes would have been degrading its standards. Thus, we would have been disqualified. Another example. When we went to inspections every 5 years instead of annually—that is, an unannounced inspection of 20 percent of family day care homes each year—we would have been disqualified in spite of the fact that the bill recommends inspections every 5 years.

Therefore, I have very serious concerns, not about setting standards, but about provoking the right kind of action at the State level to improve quality of care. In the bill I introduced today with our colleague Senator Hatch, we propose a new and more flexible mechanism for requiring States to set standards.

We need standards, I agree. But the question is, who sets the standards and how can we insure that States set standards in accord with their own needs and experience?

Just one more example of how lethal this issue of national standards can be. The original ABC bill required that latchkey providers be able to provide basic skills training and counseling.

How can any home care provider meet those standards? How can anyone set criteria to define what counseling is and that will assure that a providee can give basic skills training?

In my home State of Connecticut, the primary providers of infant care are the home care providers. If they can't take latchkey kids, because of our strict ratios about how many little kids you can have, they would have to go out of business. So by denying them latchkey kids through this provision that requires them to give counseling and basic skills training, we would have sent most of our home care providers into other lines of business and depleted infant care services in the State.

I brought this up last year. We all discussed it. It is no longer in the bill, and I appreciate that and I want that clear. But this is a good example of what happens when the Federal Government, with all the best of intentions, tries to impose standards on the States.

I am happy to work with all those concerned with quality day care. But there are better ways to address the issue of quality than by just improving standards. One of the things that I have worked long and hard on is developing grants for demonstration projects that would enable our most sophisticated child development centers to help home care providers.

We do ourselves a disservice if we don't look to the future to stimulate new approaches to quality control and oversight, and not just be anchored in a system of the past that really is failing us.

I look forward to dealing with you on these difficult issues, and thank the panel for their long and varied involvement and support.

Ms. BLANK. Can I just say that we would like to work with Mrs. Johnson. We had recognized the after-school change.

In terms of not giving States flexibility, I thought we had made the change in the House bill—I know that Senator Hatch had proposed it and it was made in the Senate bill—that could allow some change in your standards. There was not an intent not to give you some flexibility. Family day care is difficult to regulate, but we had hoped to work with you on that. The bill was changed in the Senate and I thought it was made more flexible in the House, too.

Mrs. JOHNSON. Thank you. I appreciate that. It is hard to get away from the problem that anyone above the national standards, which are set by a median, could be penalized. I look forward to working with you on this matter.

Acting Chairman DOWNEY. Mr. Coyne.

Mr. COYNE. No questions, Mr. Chairman.

Acting Chairman DOWNEY. Mr. Matsui.

Mr. MATSUI. No questions, Mr. Chairman.

Acting Chairman DOWNEY. Mr. Ford.

Mr. FORD. No questions, Mr. Chairman.

Acting Chairman DOWNEY. I want to thank the panel very much, and we will all look forward to working with each other at some point in the future.

Mr. BAUER. Thank you, Mr. Chairman.

Acting Chairman DOWNEY. The committee will next hear from the next panel, if the Chair can find it. You know who you are: Dr. Patrick Conover, policy advocate, United Church of Christ, Office for Church in Society; Mr. Louis O. Kelso, president of the Kelso Institute for the Study of Economic Systems; and Mr. Antony Ward, executive director of Child Care, Inc.

Dr. Conover, if you would begin.

STATEMENT OF PATRICK W. GRACE CONOVER, POLICY ADVOCATE, OFFICE FOR CHURCH IN SOCIETY, UNITED CHURCH OF CHRIST

Mr. CONOVER. Good morning. My name is Patrick Conover. I am a policy advocate for the Office of Church in Society, United Church of Christ. The United Church of Christ is a denomination with 1.6 million members and has a long history of advocacy on behalf of the poor and oppressed. Our General Senate, which is our most comprehensive national policy body, has spoken with regard to poverty on many occasions. I am speaking out of the context of this policy. I am not attempting to speak for all 1.6 million members.

I am pleased to have the opportunity to testify before this committee regarding this issue facing the working poor in our Nation. Many of the members of this committee have distinguished themselves as advocates on behalf of the poor. The testimony I bring you today comes primarily from two major ecumenical research ef-

forts which bear upon the topic of concern. Our office has been prominently involved in both studies.

This testimony provides a rare opportunity for you to hear from two nationwide efforts to gather the perspectives of those in poverty and those working directly with them.

It is particularly helpful to be able to present our findings within the context of a hearing that has, as part of its subject, the broader topic of the working poor. When we focus on just one legislative aspect of the problem of poverty—welfare, child care, health care, or housing—we often lose sight of the reality that those in poverty are people, whole people. They are not just clients or homeless or disabled or some aggregation of categories. Low-income people have a complex mix of strengths and weaknesses, orientations and values. Some have clear ideas about how to solve the problems of poverty, and some are as confused as many religious leaders or Members of Congress, but because they are whole people and necessarily associate with other low-income people, they realize that solutions to one or another aspect of the problems of poverty don't overcome poverty as a whole. Indeed, it is hard to overcome a single aspect of a poverty problem because all the other aspects of poverty affect any low-income person. Keeping this in mind should be helpful to the morale of those who get frustrated when any single antipoverty program fails to work as well as the design calls for. It should also help us to understand the inadequacy of criticisms of governmental antipoverty programs which boil down to blaming the victim.

The research project "Who Speaks for the Children?" was a combined effort of five national denominations, ecumenical organizations, and national low-income advocacy organizations. Five regional hearings and a national consultation were held in 1987 and 1988. Dozens of local church groups and ecumenical organizations, various Jewish institutions and Muslims participated in the hearings.

Interfaith Action for Economic Justice, an interfaith organization with membership from 32 denominations, religious organizations and faith groups, has carried forward a major study, the "Employment Project," over the last two years. The final report will be available in the near future, so my comments on the substantive findings of this project should be considered to be interim conclusions.

The "Employment Project" is based upon a series of seven site visits in 1988. The sites were chosen to disaggregate the national employment picture. We sought out representatives of different racial-ethnic groups, and spoke with a broad variety of persons—lay and clergy, union members and community activists, public servants, elected officials, underemployed and unemployed workers, and local experts on community development and employment.

At the beginning of this month we held a national consultation with religious leaders and participants from the site visits, to review findings and make policy recommendations. I will soon summarize our policy recommendations from these two studies, but first I would like you to hear a bit of the personal reality from those we learned from.

Our respondents touched our hearts and helped us to deepen our commitment, and we hope they will do the same for you. Just as

importantly, our respondents gave us a dose of reality and helped us shape our perspectives. The stories I will tell are real stories of specific people. The stories have been selected to best illustrate what we learned from the hundreds of people who shared their lives with us.

The first story is remarkable precisely because it is not exotic or special. I met "Bill" at an urban ministry service center in Sioux Falls, South Dakota. "Bill" is a white male in his mid twenties. He graduated from high school on schedule, took a job, and now is a manager in a convenience store on a full-time basis. He earns slightly more than $4 an hour and has had small raises in the last couple of years. He is single and lives alone.

"Bill's" concern seemed simple. He was worried about losing his home because he couldn't keep up his payments. This was no mansion that we were talking about, but a used mobile home, the cheapest housing he had been able to find. He wasn't worried about his poor health benefits because he was healthy. He wasn't worried about child care because he was single. He wasn't looking for an education or training program because he already had a degree and a responsible job. "Bill" was also not looking for a wife because he could not afford to get married.

"Bill" was frustrated because his life had so few opportunities, but he was not depressed or self-defeating. In short, he was doing what society expects young adults to do, and it wasn't working.

It seems that there wasn't much the service center could do for "Bill." His income was above the official poverty line and he didn't have children. He didn't fit in any of the governmental categories for assistance, but the service center had an independent and creative staff, and I later learned that they somehow figured out how to get him into a subsidized housing program. I am not sure just how they did that, but that was not the solution that "Bill" or the Government wanted.

We expect the "Bills" of this world and of our society to make it on their own. When "Bill" can't make it, we should begin to realize that the current situation can't be made right by some modest change in one aspect of the antipoverty programs to solve the poverty problems.

If Congress sees fit to pass the current minimum wage legislation, it would raise "Bill's" income from $8,000 a year to $9,300 a year in 1992. This won't bring him much closer to his dream of owning a home. If he should happen to be married and have a child by then, he would have an income equal to 88 percent of the official poverty line, but the immediate reality is that he can't make it on his own as a single person with an income above the poverty line, in a State where living expenses are rather cheap.

Now "Bill" is not complaining. He is not mad at his boss and he isn't mad at his country. He is not helping to fill up any of the statistical categories which are raised to your attention as problems. You may want to just forget about "Bill" and move on to the people you think of as having real problems, but if you do, you will be losing attention to the reality that the framework of poverty is not problem people or even people with problems, but a socioeconomic system which is simply not working for great numbers of very usual people.

"Penny," another person we know, lives in Iowa. She is on welfare. She has become experienced at being a client. "Penny" is as surprised an angry about this as you would be in her situation. She is white and in her thirties. She was raised in a middle-class family, has some college, and is highly articulate.

The first surprise was divorce, in this case divorce from a religious leader. Who is ever prepared for divorce? She is a single mother, and she isn't getting very much child support. That also surprised "Penny," but you have heard the statistics and know it is not uncommon. Many clergy are not very well paid so, as in many low-income ex-families, even when there is a legally fair settlement and child support payments come through on time, the result is still often crushing poverty.

"Penny" set out to find work, and used up her small financial reserves in an active but fruitless job search. People are emigrating from Iowa in droves because of downturns in the farm economy. "Penny" did find work for a while but, like "Bill's" job, it didn't pay very well. "Penny" had the added burden of child care when she went to work. For a while, her child care solution cost her $10 a day out of a gross pay of $28 as a child care worker for the children of other poor mothers. It may sound stupid, but "Penny" simply couldn't afford to work.

The really important question I want to ask you is whether you can see "Penny" as a resource rather than as a problem. She is educated, has good work habits, and is eager to take a job which could support her family. In fact, she is very likely to get off of welfare in the near future. She is eager for additional education and a professional career. If she earns $15,000 next year in a dead-end job, would you be satisfied? Is that what is good for our Nation?

The stories I am telling and the questions I am asking are aimed at calling your attention to the structures of opportunity in this Nation as they are experienced.

I want to tell just one more story, one more longer story. It is the story of "Mary," a young black woman who had everything against her. She is the daughter of a clergyman who had several wives and more than two dozen children. She was married off at a young age to a man who physically and sexually abused her. She got pregnant over and over again, and even though she is still fairly young, many of her children are grown or near grown.

She finally got a divorce, and later got married again to a younger man who was willing to pitch in and help with the raising of such a large family. "Mary" dropped out of school, but she has gone back to school as an adult and obtained a high school equivalency certificate. She and her husband both work, and her older children either work or help out with child care. "Mary" is also unusually articulate and is a local community leader in her low-income community, helping out with a variety of neighborhood projects.

How do you feel about "Mary" as a long-term welfare recipient? Like "Penny," she has had the grit to cope with the welfare system, and gained enough from the limited services and opportunities to get her life in good order. How fair is it that the rewards are so thin for the monumental effort "Mary" has made?

It would be easy to turn to specific legislative proposals which would fix one or another of the specific problems of "Bill" or "Mary" or "Penny," but for today I would like to lift your attention from legislative detail to a larger picture. The total of what I am trying to lift up was well put by Chuck Martoni, Mayor of Swissvale, Pennsylvania, a small community near Pittsburgh which still hasn't gotten over the devastation of the steel industry:

> Are people underemployed because business would go out of business if they paid more money, or are they underemployed because the business is making a 35 percent profit instead of a 25 percent profit? If a business can't operate without perpetuating an underclass in this country, then this country doesn't need that business. We can't have a stable country with a large underclass.

Some would have you believe that the situation we are in is just the natural result of market forces in a dynamic and changing economy. When the capitalism of Adam Smith is interpreted through the lens of social Darwinism, the survival of the fittest, people take the position that there are necessarily winners and losers. Losers are thought of as the unfit. Winners are thought of as virtuous by reason of their success. Winners can also afford incentives to legislatures to shape the rules in their favor.

Such a view of capitalism is a distortion of both Adam Smith and a distortion of the religious values, the so-called Protestant Ethic, which are presumed to be at the heart of the success of U.S. capitalism. Adam Smith presumed a social consciousness that was far distant from "economy red in tooth and claw." The Protestant Ethic developed within the context of a call to Christians to serve God through caring for people and creation.

What socioeconomic rules, then, shall govern our society? It is our perspective that the worsening circumstances of the working poor are a direct result of changes in policy directions which are making things worse.

The first change I would mention is the expansion of the "core/ring" approach to management. Those employees in the core receive standard treatment as employees, with reasonable wages, benefits and job security. Ring employees are likely to be either part time or temporary workers. Even if they are permanent, full time employees, they are treated as marginal in the sense that they receive the lowest possible pay and benefits. Job security is low because such employees are typically in positions which require little training and are unlikely to have the advantage of union representation.

Perhaps most devastating for such employees, ring jobs are not part of any ladder to success. Even though "Bill" claims the lofty title of manager, it is still clear that he has a ring job. Of course, there are also a lot of ring jobs which never were core jobs.

There are two ways to fix ring jobs. Employers might be mandated to provide more wages or benefits. Passing the minimum wage legislation would be a small improvement in this regard. The other approach would be to add on tax-based improvements in income or benefits. Representative Downey's initiative around the Earned Income Tax Credit and related issues is an example of this strategy.

Both approaches have their strengths and weaknesses, and both are needed. We need to put a proper base under the socioeconomic

structure of our society and address specific problems. For example, we need added income for low-income families, such as a reform of the earned income tax credit would provide, but we also need comprehensive child care legislation that deals with the quality and availability of service, the coordination of services and the other things that the ABC bill addresses.

The big problem with either approach is political. The Nation has not yet become sufficiently mobilized to provide the support for solving the problem. Those most directly involved are not fully aware that their problems are, in part, systematic. In this regard, I am reminded of the story of farmers who were successful for years and who are now falling into despondency and even suicide because they blame themselves for the loss of family farms.

The second big change in policy which is having severe effects is the cutback of federally-based subsidies and programs to assist those in poverty. Two prominent examples are the decline in the value of the AFDC benefits for families, and radical cuts in housing subsidies.

Too many Representatives and Senators went along with the premise that Congress could balance the budget on the backs of the poor without causing social and personal problems. Some would even have us believe that Congress is doing the poor a favor by freeing them from a dependency upon food and shelter and medicine.

What is needed is a rebalancing of the social contract and a substantial reprioritization of the values expressed in the Federal budget. Bailing out corrupt savings and loan institutions is taken as a crisis which must be fixed. Young families with employed parents living in the backs of cars is merely unfortunate. Acquiring two more full-sized aircraft carriers so that we can have 15 such ships when no other Nation has even one is considered basic to our national defense. Losing a third of a generation of children to poverty is merely unfortunate.

This Nation is making choices. You, as our elected Representatives, are making choices. Sure, there are all kinds of practical considerations, but you are also making moral choices. As a body, on balance, usually in response to presidential initiatives, Congress has been choosing against the poor for a decade. Modest improvements in specific programs have been vastly outweighed by deterioration in the socioeconomic circumstances of the poor. Such deterioration didn't just happen. It follows specific policy choices.

[The statement of Mr. Conover follows:]

THE PERSPECTIVE OF THE WORKING POOR

Dr. Patrick W. Grace Conover
Policy Advocate
Office for Church In Society
United Church of Christ

My name is Patrick W. Grace Conover, Policy Advocate for the Office for Church In Society, United Church of Christ. The United Church of Christ is a denomination with 1.6 million members and has a long history of advocacy on behalf of the poor and oppressed. Our General Synod, which is our most comprehensive national policy body, has spoken with regard to poverty issues on many occasions. I am speaking out of the context of this policy. I am not attempting to speak for all 1.6 million members.

I am pleased to have the opportunity to testify before this Committee regarding the issues facing the-working poor in our nation. Many of the members of this Committee have distinguished themselves as advocates on behalf of the poor.

The testimony I bring you today comes primarily from two major ecumenical research efforts which bear upon the topic of concern. Our office has been prominently involved in both studies.

Our studies have chosen a methodology aimed at supplementing the more usual analyses of institutional records and sample surveys. Instead of doing average type analysis in the research tradition of Emile Durkheim, we have attempted ideal type analysis in the research tradition of Max Weber. Other studies produce apparently objective facts and then theorize about the findings. Our studies lift up the subjectivity of those most intimately involved in the day to day life of poverty: both of the poor themselves and of those who work directly with the poor. This effort should not be confused with mere anecdotal presentation. In both studies, considerable effort was made to obtain a fair and fresh hearing of grass roots voices.

It is particularly helpful to be able to present our findings within the context of a hearing on the broader topic of the working poor. When we focus on just one legislative aspect of the problem of poverty: welfare, child care, health care, or housing; we often lose sight of the reality that those in poverty are people, whole people. They are not just clients, or homeless, or disabled, or some aggregation of categories. Low income people have a complex mix of strengths and weaknesses, orientations and values. Some have clear ideas about how to solve the problems of poverty and some are as confused as many religious leaders or members of Congress. But, because they are whole people and necessarily associate with other low income people, they realize that solutions to one or another aspect of the problems of poverty don't overcome poverty as a whole. Indeed, it is hard to overcome a single aspect of a poverty problem because all the other aspects of poverty affect any low income person. Keeping this in mind should be helpful to the morale of those who get frustrated when any single anti-poverty program fails to work as well as the design calls for. It should also help us to understand the inadequacy of criticisms of governmental anti-poverty programs which boil down to blaming the victim.

The research project, WHO SPEAKS FOR THE CHILDREN, was a combined effort of five national denominations, ecumenical organizations, and national low income advocacy organizations. Five regional hearings and a national consultation were held in 1987 and 1988. Dozens of local church groups and ecumenical organizations, various Jewish institutions, and Muslims participated in the hearings in Boston, Massachusetts; Cedar Rapids and Des Moines, Iowa; Atlanta, Georgia; Houston, Texas; and Seattle, Washington. Two hundred low income people, religious and community leaders, child advocates, and social service providers, gathered in Washington, D.C. in 1988 to review the regional findings and make policy recommendations.

Interfaith Action for Economic Justice, an interfaith organization with membership from thirty-two denominations, religious organizations, and

faith groups, has carried forward a major study, the EMPLOYMENT PROJECT, over the last two years. The final report will be available in the near future so my comments on the substantive findings of this project should be considered to be interim conclusions.

The EMPLOYMENT PROJECT is based upon a series of site visits in 1988. The sites were chosen to disaggregate the national employment picture. We chose some sites which have major employment problems but have not commanded major media attention, such as South Dakota and rural Alabama. Other sites had previously gained much attention, such as Pittsburgh, Pennsylvania, but have now slipped from the public eye. Most sites we visited were plagued by both high unemployment and underemployment, but other sites, such as Boston, Massachusetts, are experiencing labor shortages. In each area, including Modesto-Merced-Stockton and Oakland California, and Houma-Thibodeaux Louisiana, we sought out representatives of different racial-ethnic groups and spoke with a broad variety of persons: lay and clergy, union members and community activists, public servants, elected officials, underemployed and unemployed workers, and local experts on community development and employment. We conducted guided but open-ended interviews and held numerous group meetings as well. The shaping of our research efforts and our policy analysis was also influenced by two groups who have been doing similar kinds of analysis: the Commission on Religion in Appalachia and the New Jersey Council of Churches. At the beginning of this month we held a national consultation with religious leaders and participants from the site visits to review findings and make policy recommendations.

I will soon summarize our most important policy recommendations from these two studies. But first I would like you to hear a bit of the personal reality from those we have learned from. Our respondents touched our hearts and helped us deepen our commitments and we hope they will do the same for you. Just as importantly, our respondents gave us a dose of reality and helped us shape our perspectives. It is easier to learn the theories and facts. What is harder is to gain the most helpful perspective for accomplishing the goals we mostly share. Except for those who want to turn their backs on the problem by blaming the victims, there is a wide consensus in our nation that government should shape the social-economic conditions of our society so that all may make their appropriate contributions and all may derive sufficient resources to live well. You would not be holding these hearings if you did not agree with us that the expanding numbers of the working poor is a national scandal. You would not be listening to this testimony unless you believed that those most immediately involved had something important to say.

The stories I will tell are real stories of specific people. The stories have been selected to best illustrate what we learned from the hundreds of people who shared from their lives with us.

The first story is remarkable precisely because it is not exotic or special. I met "Bill" at an urban ministries service center in Sioux Falls, South Dakota last year. "Bill" is a white male in his mid-20's. He graduated from high school on schedule, took a job, and now is a manager in a convenience store on a full-time basis. He earns slightly more than $4.00 an hour and has had small raises in the last couple of years. He is single and lives alone.

"Bill's" concern seemed simple. He was worried about losing his home because he couldn't keep up the payments. This was no mansion that we are talking about, but a used mobile home, the cheapest housing he had been able to find. He wasn't worried about his poor health benefits because he was healthy. He wasn't concerned about child care because he

was single. He wasn't looking for an education or training program because he already had a degree and a responsible job.

"Bill" was also not looking for a wife because he could not afford to get married. He wasn't into drugs or heavy drinking. He was frustrated because his life had so few opportunities but he was not depressed or self-defeating. He didn't live in a bad neighborhood. In short he was doing what society expects young adults to do. AND IT WASN'T WORKING.

It seemed that there wasn't much the service center could do for Bill. His income was above the official poverty line and he didn't have children. He didn't fit in any of the governmental categories for assistance. But the service center had an independent and creative staff and I later learned that they had figured out how to get him into a subsidized housing program. But that was not the solution that "Bill" or the government wanted. We expect the "Bill's" of the world to make it on their own. When "Bill" can't make it we should begin to realize that the current situation can't be made right by some modest change in one aspect of the poverty problem.

At $4.00 an hour a "Bill" has a gross income of $8,000 per year. Members of Congress felt they needed an annual wage INCREASE of more than $8,000 a year in an attempt to keep up with the rising cost of living. If Congress sees fit to pass the current minimum wage legislation which would raise "Bill's" income to $4.65 by 1992 he would then have $9,300 in gross annual income. This won't bring him much closer to his dream of owning a home. If he should happen to be married and have a child by then, he would have an income equal to 88 percent of the official poverty line. The immediate reality is that he can't make it on his own as a single person with an income above the poverty line.

"Bill" is not complaining. He is is not mad at his boss and he isn't mad at his country. He is not helping to fill up any of the statistical categories which are raised to your attention as problems. You may want to forget about "Bill" and move on to the people you think of as real problems. But if you do you will be loosing attention to the reality that the framework of poverty is not "problem people" or even "people with problems" but a socio-economic system which is simply not working for great numbers of very usual people.

"Penny" lives in Iowa. She is on welfare. She has become experienced at being a client. "Penny" is as surprised and angry about this as you would be in her situation. She is white and in her 30's. She was raised in a middle class family, has some college, and is highly articulate. The first surprise was divorce, in this case divorce from a religious leader. Who is ever prepared for divorce? She is a single mother and she isn't getting very much child support. That also surprised Penny but you have heard the statistics and know it is not uncommon. Many clergy are not very well paid, so, as in many low income ex-families, even when there is a legally fair settlement and child support payments come through on time, the result is still crushing poverty.

"Penny" set out to find work and used up her small financial reserves in an active but fruitless job search. People are emigrating from Iowa in droves because of down turns in the farm economy. "Penny" did find work for a while but, like "Bill's" job, it didn't pay very well. "Penny" had the added burden of child care when she went to work. For awhile her child care solution cost her $10 per day out of a gross pay of $28 per day as a child care worker for the children of other poor mothers. It may sound stupid, but "Penny" simply couldn't afford to work.

"Penny" testified movingly about the "attitude" she received from social workers, pharmacists, and others when she had to present her credentials

as one of the assisted poor. She was literate and able to keep up with the paper work and other work of receiving assistance. What was getting her down was the stigma and the hassles of the "system." We have let our images of the "welfare cheat" shape the orientation to giving assistance. Last year's welfare act added another layer of hostility into an already demeaning system. If, as part of the Ways and Means Committee, you want to go after those who are defrauding the government, why not focus on those who are stealing the big bucks, the upper income people who cheat on their taxes and the defense contractors who call their larceny "business as usual." Do you defame a whole class of Savings and Loan executives just because some have stolen a few billions dollars.

The really important question I want to ask you is whether you can see "Penny" as a resource rather than a problem? She is educated, has good work habits, and is eager to take a job which could support her family. In fact, she is very likely to get off of welfare in the near future. Most of those who go on welfare do exit fairly quickly. If she is earning $9,300 in 1992 are you prepared to declare that her problems are over? She is eager for additional education and a professional career. If she earns $15,000 next year would you be satisfied? Is that what is good for our nation?

The stories I am telling and the questions I am asking are aimed at calling your attention to the structures of opportunity in this nation as they are experienced.

This Committee has had a lot of testimony over the last few years which has been aimed at disaggregating national statistics. You know that the unemployment statistics hide major sectors of economic disaster. I visited the Redbud Sioux Reservation last year and they are so unemployed they don't even show up in the discouraged worker category, much less the plain old unemployed who make up the usually quoted national statistic. You also know that the average increase in per capita and per family income in the 1980's hides a widening gap between rich and poor. And you know that young families with young children are the most overrepresented sector in poverty statistics. It doesn't take a genius to figure out what this means for the long term economic and social health of this society.

I want to tell you one more story. It is the story of "Mary," a young black woman who had everything against her. She is the daughter of a clergyman who had several wives and more than two dozen children. She was married off at a young age to a man who physically and sexually abused her. She got pregnant over and over again and, even though she is still fairly young, many of her children are grown or near grown.

She finally got a divorce and later got married again to a younger man who was willing to pitch in and help with raising a large family. "Mary" dropped out of school but she has gone back to school as an adult and obtained a high school equivalency certificate. She and her husband both work and her older children either work or help out with child care. "Mary" is also unusually articulate and is a local community leader in her low income community, helping out with a variety of neighborhood projects. How do you feel about "Mary" as a long term welfare recipient? Like "Penny" she had the grit to cope with the welfare system and gained enough from the limited services and opportunities to get her life in good order. How fair is it that the rewards are so thin for the monumental efforts "Mary" has made?

It would be easy to turn to specific legislative proposals which would fix one or another of the specific problems of "Bill," or "Mary" or "Penny." You might make sure Mary keeps her Medicaid card for more than

a year when she leaves AFDC. You might broaden the eligibility requirements so that it would be easier for "Bill" to find subsidized housing. You might not only defend but enrich Pell grants for people like "Penny." All of these things need doing, and much more. The way Congress does legislation these days it will take such attention to detail to incrementally fix up the host of anti-poverty measures. No doubt my Office will by speaking to your offices about such detail for years to come. Such detail is important.

For today I would lift your attention from the endless legislative detail to a larger picture. The tone of what I am trying to lift up was well put by Chuck Martoni, Mayor of Swissvale, PA, a small community near Pittsburgh which still hasn't gotten over the devastation of the steel industry.

"Are people underemployed because businesses would go out of business if they paid them more money or are they underemployed because the business is making a 35 percent profit instead of a 25 percent profit? If a business can't operate without perpetuating an underclass in this country, then this country doesn't need that business. We can't have a stable country with a large underclass." (Interim Draft Report, Employment Project, Interfaith Action for Economic Justice, p. 14.)

Some would have you believe that the situation we are in is just the "natural" result of market forces in a dynamic and changing economy. When the capitalism of Adam Smith is interpreted through the lens of social Darwinism, "the survival of the fittest," people take the position that there are necessarily winners and losers. Losers are thought of as the unfit. Winners are thought of as virtuous by reason of their success.

Such a view of capitalism is a distortion of both Adam Smith and a distortion of the religious values, the so-called "Protestant Ethic," which are presumed to be at the heart of "success" of U.S. capitalism. Adam Smith presumed a social conciousness which was far distant from "economy red in tooth and claw." The "Protestant Ethic" developed within the context of a call to Christians to serve God through caring for people and creation.

It is our perspective that the worsening circumstances of the working poor, and also of the unemployed, are a direct result of changes in policy directions which are infecting our society.

The first change I would mention is the expansion of the "core/ring" approach to management. Those employees in the core receive standard treatment as employees, with reasonable wages, benefits, and job security. "Ring" employees are likely to be either part-time or temporary workers. Even as permanent full-time employees they are treated as marginal in the sense that they receive the lowest possible pay and benefits. Job security is low because such employees are typically in positions which require little training and are unlikely to have the advantage of union representation. Such "ring" jobs are more likely to be found in the expanding service industries and are more likely to be filled by women than men. Perhaps most devastating for employees, "ring" jobs are not part of any ladder to success. Even though "Bill" claims the lofty title of "manager" it is still clear that he has a "ring" job.

There are two ways to "fix" ring jobs. Employers might be mandated to directly provide more wages or benefits. Passing the minimum wage legislation would be a small improvement in this regard. The approach of Senator Kennedy to health care is another example. The other approach would be to add on tax based improvements in income or benefits. Rep. Downey's initiative around the Earned Income Tax Credit is an example of this strategy. Increased housing subsidies would be another example, as proposed by Rep. Gonzalez.

The big problem with either approach is political. The nation has not yet become sufficiently mobilized to provide the support for solving the problems. Those most directly involved are not fully aware that their problems are, in part, systematic. In this regard I am reminded of the stories of farmers who were successful for years and who are now falling into despondency, and even suicide, because they blame themselves for the loss of family farms.

The second big change in policy which is having severe effects is the cutback of federally based subsidies and programs to assist those in poverty. Two prominent examples are the decline in the value of AFDC benefits for families and the radical cuts in housing subsidies. Too many Representatives and Senators went along with the premise that Congress could balance the budget on the backs of the poor without causing serious social and personal problems. Some would even have us believe that Congress is doing the poor a favor by freeing them from a dependency upon food and shelter and medicine.

What is needed is a rebalancing of the social contract and a substantial reprioritization of the values expressed in the federal budget. Bailing out corrupt Savings and Loans institutions is taken as a crisis which must be fixed. Young families with employed parents living in cars is merely unfortunate. Acquiring two more full-sized air craft carriers so that we can have 15 such ships, when no other nation has even one, is considered basic to our national defense. Losing a third of a generation of children to poverty is merely unfortunate.

THIS NATION IS MAKING CHOICES. YOU AS OUR ELECTED REPRESENTATIVES ARE MAKING CHOICES. There are all kinds of practical considerations but YOU ARE MAKING MORAL CHOICES. As a body, on balance, Congress has been choosing against the poor for a decade. Modest improvements in specific programs have been vastly outweighed by deterioration in the socio-economic circumstances of the poor. Such deterioration didn't just happen. It follows specific policy choices.

We met "Corrinne" from Boston. She had taken advantage of the famed Massachusetts ET program. She left welfare and now brings in a $6.00 an hour paycheck. Two bedroom apartments in Boston are hard to find at $650 dollars a month. She isn't homeless because she is spending 65 percent of her gross income on rent. That is only slightly above the average for low income single parents. "Corrinne" lives in grinding poverty, fighting bravely to provide better opportunities for her children.

It isn't accidental that there is little or no affordable housing in Boston and in other cities. At the beginning of this decade the federal government was subsidizing the construction of over 1 million units of affordable housing a year. Now Congress feels good about defending the subsidization of 25,000 units a year. Private industry has responded to the "market" for affordable housing with the production of a paltry 32,000 units in 1987. Congress needs to increase spending on affordable housing by about $3 billion per year just to stand still. Even if Federal programs stood still the nation would still be losing affordable housing, on balance, to gentrification, parking lots, and "economic progress" generally.

If Congress turns around and moves $50 billion dollars a year from military spending and other places to programs and benefits for low income people, and if Congress additionally mandates increased pay and benefits for employees, the job would not yet be done, though such efforts would certainly brighten the prospects for the underemployed.

Congress must also revisit the multiple efforts of the last two decades

to stimulate economic development in areas of persistent poverty and in single industry areas devastated by the loss of that industry. These areas have struggled in times of general prosperity and collapsed during economic decline. Macroeconomic changes in interest rates, taxes, trade, etc., have not been effective in overcoming decades of problems. Strategies to bring in big employers or major production plants have often not had the expected effect on local economies. Furthermore, "jobs on wheels" don't help the national economy or the overall rate of employment. If a business were to relocate from Minneapolis to Martin, South Dakote, it may help Martin but it will surely hurt Minneapolis.

In any case, at least one part of the solution for areas of persistent poverty is improved local economic development with at least part of the control being in the hands of workers and local leaders who have an interest in seeing that the economic development achieved has a payoff for local workers and communities and not just for distant stock holders. Issues of scale and local flexibility are at the heart of these debates. What we can report to you is that the spirit of enterprise can yet be found in some of the most depressed parts of our nation. If development policy can focus on the strength of local leadership and not just on human or other resources to be exploited by existing businesses, then a big step will have been made toward getting local people really involved in healing deep economic wounds we have inflicted on ourselves.

If one thinks of the market system of capitalism through the lens of applause for fierce economic competition, of economy "red in tooth and claw," we need to remember it is not just two businesses in an economic battle, one fails to see that the redness is the result of a nation eating its fingers and toes to satisfy its stomach. This is a prescription for socio-economic gangrene. We think Mayor Martoni is right, federal policy can shape an economy in which current and future businesses will operate in a way which is not only good for themselves but good for the society as a whole. Let business competition have not only a level playing field but enough direction so that leagues and players as well as teams can prosper.

Following is a list of specific policy recommendations drawn from the two studies which have formed a basis for this testimony.

Policy Recommendations

1. Current employees need to receive adequate pay and benefits with reasonable job security.

- The minimum wage should be lifted to its traditional standard, not merely to $4.65 an hour in 1992.

- The federal government should do its part to create an adequate child care system, which has sufficient services available, provides good quality care for children, and is affordable for all.

2. People need education and training for jobs that pay livable incomes.

3. Families need affordable housing.

4. Families need access to food and to health care.

5. Families need adequate income, preferably through employment, but if not through employment, through adequate benefits.

6. We need public service employment in some areas. With a proper public service employment program there would be no need for demeaning workfare. Members of our society need a way they can contribute to the common good as well as a way to receive resources to sustain life.

7. The rights of labor to organize and engage in collective bargaining need to be protected and strengthened, not only for wages and benefits, but also for safe, healthy, and humane working conditions.

8. Funding should be fully restored for the Equal Employment Opportunity Commission as one means for continuing to wrestle with racism in our economic system.

9. We need improved community based economic development which produces employment and other economic benefits which are positive for local workers and communities, the involved businesses, and for the nation as a whole.

The first five recommendations are common to both reports. The last four recommendations come primarily from the EMPLOYMENT PROJECT. The Report, WHO SPEAKS FOR THE CHILDREN, is available for members today. The final report on the ECONOMIC PROJECT will be provided to members as soon as it is available. These reports go into more detail on the above policy recommendations.

Federal role in the development of HDTV is that so many different issues are involved in this particular topic.

It seems to me that if you look carefully at what is involved, HDTV is in essence a sort of a Rorschach blot for whatever agenda you bring to the table. There are many agendas that are being brought to the table with this discussion. Some of the agendas I think are absolutely critical agendas that deserve the utmost prominence in our discussions of national policy. Other parts of the agenda I am less sure about.

So if I find myself in the role of perhaps a skeptical voice, to some extent, on some of the points today, I apologize in advance for raining on what is otherwise a very interesting and forward-looking parade. I think it is important to bring out exactly what the issues are and to talk about them clearly, so let me just sort of run down the list of what I see in some of the discussions I have heard thus far, and I must confess I was not present or able to listen to the panel hearings yesterday.

The first point that everyone seems to be talking about is the need to restructure technology policy in the United States to support the commercial technology base of this country. In particular, explicit recognition of Government support for basic science and middle ground research as a legitimate function of Government and organization of Government to accomplish that end. That, it seems to me, is the broadest issue we are talking about today and an exceedingly important issue to discuss.

The second issue we are talking about, a somewhat narrower issue, perhaps, is about various proposals basically to technically revitalize the U.S. semiconductor industry. Some people when they talk about HDTV see salvation for the semiconductor industry on the horizon, and of course, the consumer electronics industry which we have been discussing briefly.

A third item being brought to the agenda in these discussions is HDTV, or more appropriately, high definition imaging systems and the transmission systems that go with them as an opportunity, an opening to build a high capacity information network for the United States infrastructure for the information economy of the next century. That has the added attraction of building on an area where the United States has great strengths rather than merely trying to match our competitors.

A fourth topic, and perhaps the narrowest version of what HDTV is all about, is merely the idea of some sort of Federal support for R&D work on a high resolution digital imaging system. I am staying away from the word "TV" because I think the technologies here are really much broader. If you are really interested in the year 2000, or the year 2020, consumer electronics may merge into industrial and office automation, and who knows where that may go. So perhaps you ought to drop the word "TV" somewhere along the line.

A fifth issue that some people are bringing to the table is the issue of the Government participating directly in building or subsidizing production facilities for U.S. consumer electronics firms. That is an issue that has been brought to the table under the same framework. A sixth issue is some discussion, at least, in discussions I have heard in fairly major changes in U.S. antitrust laws to

exempt production joint ventures, some sort of blanket exemption in areas such as this.

I think these different items on the agenda have varying degrees of importance, and I think it is important that we discuss each one quite clearly and quite specifically and make a case on each point rather than sort of lumping them together. The lumping them together has the advantage, perhaps, of generating a wide interest base and a political support base, but I think the issues are so important that it is important to fully air them.

Let me just in what remains of my time for this brief statement give you a shot from the hip, so to speak, on what I see the issues as. I think a good case, an excellent case can be made for the first three points I raised. That is, I think the overriding critical issue, indeed what I think the central issue of our time is the need to restructure our technology policy to support the commercial technology base, and HDTV is merely one item well down on that list, in my opinion.

Second, I think the case for some sort of Government program to revitalize the U.S. semiconductor industry and the consumer electronics industry, to some extent, is also a worthy objective and we ought to be talking about what kinds of measures. First of all, we ought to be talking about how we diagnose the problem, what the nature of the problem is, and then how we can attack that problem and then move on and do something about it. I think the Sematech, which we have moved forward with, is a good example of the sort of experiments we ought to be undertaking.

As far as the opportunity to build a high capacity information network for the United States, I think that is a critically important topic which deserves further discussion and perhaps a hearing in i's own right. For Federal support for R&D work in high resolution digital imaging systems, I would basically support some sort of project along those lines, as I would support many other projects, but I don't necessarily think it is the most important item on our R&D agenda for this country. It is an example of the sort of thing we should be doing but perhaps not the most important example.

The last two items, direct Government subsidization of production facilities, changes in antitrust to exempt production joint ventures, I think substantial discussion is required to make the case for those points. There may in some specific instances be an argument to be made, but certainly that case ought to be made and made quite specifically.

Where do I think we ought to be going with all of this? I mean what is the bottom line here? It seems to me that what really is going on here and what this hearing in a sense really is about is about the point that Government should be—we should these days be owning up to support for our commercial technology base as a legitimate function of Government of significant interest and importance to the high technology economy of tomorrow for the United States, and a matter of grave national importance.

Second, I think we ought to be moving ahead with experiments to support new kinds of ventures to support R&D in this country. I think there are certain characteristics we ought to be looking for in those proposals, things like an agenda generated by industry, and I think what is going on with HDTV now and the participation

of industry in sort of generating proposals is a valuable thing to be encouraged.

I think it is useful to talk about consortia partially funded by Government as long as Government pays for a minority of the funds used in such consortia. I think the onus ought to be on industry to essentially put its money where its mouth is, select good projects, sharpen the mind, if you will, by funding at least half of the cost for such consortia. I think there is a good case to be made for Government support for investment in precommercial, enabling technologies for commercial products and development.

Most importantly, or perhaps not most importantly but certainly an issue that hasn't been discussed and crucially important right at this moment, I would argue, in Washington at the onset of a new administration is the need for a high level institution, a high level agency, a high level spokesperson to speak for technology issues within the Government, to safeguard programs, to support middle ground research and basic science, to scan the world horizon, to produce proposals, to confer with industry, to be a contact point to facilitate industry moving ahead and developing an agenda, and then going to Government and trying to put that agenda on the national table.

Again, I thank your for your time and I look forward to questions.

Mr. MARKEY. Thank you, Mr. Flamm, very much. Good testimony.

Our next witness is Mr. Fred Branfman, who is Director of Rebuild America.

STATEMENT OF FRED BRANFMAN

Mr. BRANFMAN. Mr. Chairman, it was inspiring yesterday to realize that the members of this subcommittee have reached consensus on the importance of high definition television for America's industrial future. I cannot remember a time when Congress has been so far ahead of the Executive, media and business on an issue like this. I really think you are to be congratulated for it.

Because of the sophistication of the discussion yesterday, I won't get into the details at this point, although I have addressed them in my testimony. I would like to talk about it during the question and answer period. But if we take as our hypothesis that high definition television is a critical industry for our future both because of its potentially huge market and, more importantly, because it is going to drive technology in other areas, I would like to talk about what do we do at that point, what I say are the two key issues that this committee might consider.

In my mind this is first: How do we convince the President and congressional leaders, the top leaders of Congress to place their number one priority on industrial revitalization as symbolized by HDTV, using HDTV as the symbol; and two, how do we devise a new industrial strategy for this country so that HDTV becomes the model for developing all of the other key strategic industries of our future.

On May 25, 1961, a new president, bogged down after the Bay of Pigs and the Gagarin space flight, refocused his administration by

calling a special session of Congress to launch the space age. I believe it is going to take that kind of national focus for this country to even develop an HDTV industry of the kind that we all want that is using U.S.-made components, particularly semiconductors, not to mention all the other key industries that we are going to be looking at.

The reason we need this kind of major national focus, which only the President, the Speaker of the House and the Senate Majority leader can provide, is because America's industrial base is now so far eroded that our own Defense Science Board warns that national security is threatened. Undersecretary of Defense Frank Costello has reported—I guess it is former undersecretary, or about to be—that there are now scores of technologies in which other nations are developing the most advanced manufacturing technologies for the most advanced product. Let me repeat that; scores of technologies.

The simple and alarming fact is that America today has become the world's number two industrial leader for the first time in a century, threatening us with generations of decline like Spain, France and Great Britain before us. History is not kind to nations that lose control of their economic destiny, and we are going to need extraordinary measures to regain it in the coming decade.

Let's make no mistake; HDTV is only one of dozens of industries that are going to appear before this very committee in the 1990's to seek help against strong foreign competitors, particularly in the likely event that we enter a recession and debt-laden U.S. firms confront Japanese countries backed by their nation's large cash surpluses. If this committee is to respond successfully, it will need both the new industrial model, which HDTV should help propel us into, and two, support from the highest levels of our public and private leadership.

In terms of this new industrial model, it seems to me that HDTV should provide a new model for industrial revitalization. If there is one lesson from the past decade, it is that laissez-faire has failed. We need instead a new industry-led strategy consisting of three components; industry responsibility, full Government support, and long-term strategic analysis.

Very quickly, by industry responsibility, the Project Eureka in Europe, as you probably know, is a very interesting model for the United States. Four European countries control the HDTV Directorate. There are 26 companies in eight separate nations involved, 10 projects, most of them led by private companies, running the full range of issues involved with HDTV. I think we are going to need some kind of model like that and that Congress is going to need to make that happen.

Let me say that I think Congress itself might have to consider the unprecedented in this case, given the fact that we have never really talked about how we create a new industry before from so small a base when we are so far behind. One thought I had is it might make sense to establish a joint House-Senate committee to actually enter into ongoing discussions with groups like the AEA, with the Executive branch, to try to come up with some kind of a team effort where everybody is thinking together on a daily basis how to make this thing happen rather than using the model we

now have, which I think is probably more appropriate to an earlier era.

So the first thing we need is industry responsibility, and I don't know quite how to make that happen. Obviously, it is up to industry to do that if we are saying they are going to lead this. I have a hunch that if Congress was meeting with them, thinking this through with them, giving them support, not to mention the Executive Branch, it might make them even more responsive to leading in this area.

Second, once industry takes the lead, I think we need full Government support. I certainly strongly support the Ritter-Levine bill. I think it is definitely taking us in the right direction, but I think we need to recognize that we are talking about billions of dollars here over the next decade if we are going to get the job done.

I will give you one example. The Japanese invested $3 billion in the last 6 months of 1988 to build new memory chip production lines in Japan. Most of this is going to go for HDTV, intelligent work stations and 32-bit personal computers; 67.5 percent, according to their figures, all of which—and as you know, those three items are going to more and more resemble each other.

If we are going to start talking about that kind of money that is required, of course, not all of that has to come from Government. At least it doesn't have to affect the deficit. Hopefully, things like low cost Government loans or revising the antitrust law can make this more attractive for the private sector, loan guarantees. But still, I think we are going to have to be talking about direct Federal expenditures on every level that Mr. Flamm mentioned.

I want to note here when you start talking about where are we going to find that money, that if we were to gradually shift from today's two-to-one civilian-military ratio in Federal R&D funds to the historic 50–50 levels that we enjoyed between 1960 and 1980, we could generate over $15 billion for civilian commercialization over the next 3 years without increasing the Federal deficit. Since the Defense Science Board has found that civilian commercialization is critical to national security, accomplishing this should be more possible than ever.

Finally, we need an agency like the Defense Science Board that looks at our defense needs, looking at our commerce needs, our commercial needs over the next decade. Candidates include the new Competitiveness Policy Council, which Congress might consider funding, but I think a better model might be the Defense Science Board, where you have CEO's actually taking the responsibility. That is the kind of economic strategy we need.

Let me just finish by talking a little bit about what I think is the critical issue; what is going to be our political strategy here. How do we focus this Nation on making all of this happen? I think the political is the key much more than the economic. If we decide as a Nation that we are going to do this, we will figure out how to get it done. Our problem right now is we are not focusing.

Now, I think it is obvious the American people will support placing our top priority on industrial revitalization. They already know the truth. A recent poll indicates that they believe by a margin of 54 to 29 that Japan, not the United States, is the world's leading

economic power. In other words, while many of our political leaders still are afraid of talking gloom and doom and raising this issue, the American people know it and they have consistently supported Governors at the State level campaigning for goals like education, economic development, even when they raise taxes because they believe in competitiveness.

Our problem right now is to generate the kind of leadership we have seen at the State and local level at the national level. Under our system, only top congressional leaders and, above all, the President can mobilize the kind of resources and cooperation we will need to regain the industrial cutting edge. The President has not yet set his priorities, and a major effort is needed to convince him now that all of his other national goals—education, social, environmental and defense—require first revitalizing our industrial base.

Is it too much to hope that the members of this committee might convince Congress' leaders and the President to launch a decade of industrial revitalization, perhaps beginning with the joint session of Congress this May 25, the 18th anniversary of John F. Kennedy's historic speech? I don't know, of course, but I do know this: Only efforts on this scale can develop HDTV and the other strategic industries of the 1990's. Without such leadership our future is in jeopardy. We owe far more to ourselves, our children and to all those who will come beyond them.

Thank you.

[Testimony resumes on p. 215.]

[The prepared statement of Mr. Branfman follows:]

Testimony by

Fred Branfman

INTRODUCTION: THE U.S. AS #2

To understand the significance of High-Definition Television (HDTV) for America's future, one needs first to recall its past.

Not only has everyone in this room grown up during a time when the United States has been a world leader in industrial innovation, but so too did our parents, grandparents, and their parents before them. Alexis de Tocqueville reported in 1840 that "no people have made such rapid progress in trade and manufactures as the Americans... a stranger is constantly amazed by the immense public works executed ... The longest railroads that have been constructed are in America. The Americans make immense progress in productive industry, because they all devote themselves to it." (3)

By 1860, historian James McPherson writes, "the more advanced sections of the economy had already given the United States the world's highest standard of living and the second-highest industrial output, closing in fast on their British cousins despite the latter's half-century start in the industrial revolution ... What was new to European observers in 1851 was the American technique of making each part by a special-purpose machine, which could reproduce an endless number of similar parts within finer tolerances than the most skilled of craftsmen could achieve. The British named this process 'the American system of manufactures,' and so it has been known ever since."

And the advent of the 20th century and Henry Ford's assembly line made us the world's undisputed industrial leader. America's capacity to hold the industrial cutting-edge - to not only invent but manufacture new products - has given birth to virtually every major industry this century: automobiles, steel, housing, radio, television, household appliances, telecommunications, semiconductors, and computers. No living American can recall a time when his or her nation was not the world's leading industrial power.

And our industrial supremacy, of course, was also the key factor behind much of the rest of our success. We were not the decisive factor in World Wars I and II because of the size or experience of our fighting forces. In fact, we were deficient in both areas. Our military power throughout the 20th century was a result of our industrial power, and not vice versa. And our

industrial strength has also been the source of our high living standards, our ability to forge social cohesion among immigrants from every nation on earth and, ultimately, our capacity to sustain freedom, democracy and individual choice.

Perhaps it is because our lead in industrial innovation is so ingrained in our culture us that we have thus far failed as a nation to acknowledge the shocking fact that America has today lost its role as world industrial leader.

We do not serve the American people or the world by euphemisms, however, so let us put it plainly: today, for the first time in a century, America is no longer the world's leader in manufacturing innovation. We are #2 to Japan.

Our loss of the manufacturing cutting-edge is total, and across the board. It began in the early 1970s, when the Japanese first copied, and then surpassed us, in such basic manufacturing industries as autos and steel. It continued into the 1980s when they moved up the technology ladder and began to dominate memory chip production. Perhaps the most significant development occurred in consumer electronics, when they began to develop such products as videocassette recorders and compact disk players that no U.S. company even produced. Today only one U.S. company, Zenith, is still in consumer electronics - and it is under strong pressure to sell its consumer electronics division.

In addition, we face a particularly alarming situation as we approach the 1990s. Not only have we been bested on the field of economic battle in existing industries, but our top competitors today lead us in developing the new technologies that will drive economic growth in the 1990s and beyond.

A June 1987 Commerce Department study identified 7 key technology areas - in addition to superconductors - that determine who controls the global ecoonmy in the coming decade. These are advanced materials, biotechnology, electronics, computing, automation, medical technology, and thin layer technology. (4)

There is a growing consensus among experts that the United States has today fallen behind the Japanese in commercializing most of these key new technology areas. And even in those areas in which we are still ahead, like biotechnology, industry leaders warn that superior Japanese cash reserves and their new focus on promoting innovation could see Japan control future commercialization of new products.

The Defense Science Board recently summed up our disturbing industrial position when it reported that:

> "In the [last] eight years ... America's technological superiority has diminished ... The continued deterioration of the industrial and technology base diminishes the credibility of our deterrent ... While American computer technology is still

competitive with foreign systems, we are losing out in the semiconductor field. Because of this, foreign computers could surpass us in the immediate future ... Other critical technologies further demonstrate our loss of leadership. The numerically controlled machine tool industry is now led by Japan. Their lead in flexible manufacturing systems, a key to many complicated manufacturing tasks, is growing each year. Similarly, America has lost its leadership in precision optics in the past two decades." (5)

Frank Costello, Under Secretary of Defense (Acquisition), reported in July 1988 that:

"There are ... serious indications of decline in sectors of the industrial base that are fundamentally important to national security and to continued American leadership in advanced technologies. Particularly devastating in the long-term is the loss of key production technologies and equipment. In some vitally important technologies, such as machine tools and electronics manufacturing equipment, the erosion has been particularly severe. These are but the leading edge of scores of technologies in which other nations are developing the most advanced manufacturing technologies for the most advanced products." (6)

The evidence is thus clear: the United States has lost its world lead in industrial innovation, and we have no higher national priority than regaining it. America may never again be the world's undisputed industrial leader. But it cannot retain its quality of life until it at least shares the lead with its top competitors.

I. CONGRESS AND AN HDTV "INDUSTRY-LED STRATEGY"

From this perspective, HDTV represents a new danger and opportunity for the United States. It is unprecedented in our time for Congress to consider how to help create an entirely new industry with such high potential stakes for our economy.

This nation has, of course, experience in developing infant industries. During the post-war era alone, America gave birth to huge new industries like semiconductors and computers. And we have witnessed other nations develop important new products like VCRs and compact disk players.

What is unprecedented about HDTV, however, is that never before have we lagged so far behind other nations in developing so large an industry from so small an existing base.

As the submissions to this subcommittee demonstrate, HDTV will be an extraordinarily important industry in the 1990s and beyond. HDTV itself represents a huge total market conservatively estimated at $170 billion by the American Electronics Association between now and the year 2010, and this estimate does not include the major new markets that will directly spin off from it, such as HDTV VCRs, HDTV video tapes, and HDTV computer monitors.

What is even more important, however, is that HDTV will drive technology and industrial developments in numerous components which are used in turn in dozens of other products and industries.

HDTV represents what Richard Elkus Jr. of Prometrix calls an "interrelated end-use market," which will drive development of dozens of components, products and industries. One needs to consider at least 4 related industrial impacts:

(a) HDTV components - HDTV will drive the development of dozens of key electronic components, most importantly semiconductor chips and sophisticated electronic components used in new display technology.

(b) HDTV products - The HDTV industry will also spur the creation of numerous related HDTV products such as HDTV VCRs, HDTV videotapes and movies, High Definition computer monitors, with a particularly great potential impact on terrestial broadcasting and the entertainment industry.

(c) Related industries - HDTV will also help drive digital technology development which, as MIT's Charles Ferguson notes, will in turn affect other huge markets. The most important of these is the computer industry, which will be transformed in part by new storage and display technology developed through HDTV. Also affected will be the telecommunications industry as HDTV transforms the ground, cable, direct broadcast and fiber-optic transmission, the office equipment industry for products like photocopiers and facsimile machines, and the photo industry through new electronic imaging devices of all kinds.

(d) Unrelated industries - The components developed by an HDTV industry will have a profound impact when used in many other products in our economy. The Europeans, for example, are now developing new navigation systems relying on many HDTV techologies that will equip drivers of future automobiles with the capacity to plot out their route, avoid traffic jams, and travel in the most efficient way possible. If they succeed before us, it could clearly affect the U.S. auto industry's market share.

The danger is clear. America cannot afford to sit on the sidelines and let other nations develop an HDTV industry without our participation.

If HDTV represents a danger, however, it also presents an unprecedented opportunity.

Properly developed, an HDTV initiative can be provide a model for not only developing the HDTV market, but launching similar efforts to regain the cutting-edge in the other great industries of the future.

Let us be clear: HDTV will not by itself solve America's industrial problem. We need parallel efforts to develop computer, telecommunications, and office equipment industries, as well as the future industries that will be spawned from superconductors and the technology areas identified in the Commerce Department report.

If we can create a new HDTV industry, however, it will serve as a model for these other efforts that will need to be made.

Over the long run, regaining the industrial lead will require a dramatic overhaul in the three key ingredients of economic growth: capital markets, labor and technology development. I include for the record a *Rebuild America* White Paper entitled An Investment Economics For The Year 2000, authored by Nobel Laureate Robert Solow, Lawrence Chimerine, Pat Choate, Paul Krugman, Robert Reich, Lester Thurow and Laura Tyson. It lays out the overall "investment economics" we need to increase the national savings rate, lower capital costs, discourage speculation, improve education and training, encourage workplace democracy, and promote civilian commercial technology development.

Unfortunately, however, we cannot wait for the overall economy to be restructured before launching a more targeted effort to regain control of the industries of the future. We do not even know at this point whether we will ever reduce the deficit, let alone achieve the other macroeconomic reforms needed to provide long-term capital and a skilled workforce to our industry.

If America is to revitalize its industry, it needs now to adopt a new and targeted strategy, led by industry not government, to develop the new technologies of the future.

Congress's role in supporting such an industry-led strategy needs to be as unprecedented as the challenge we face.

Congress is being asked to develop legislation pertaining to an industry which does not even exist yet, at a time when foreign competitors are far ahead, and when even those companies that have expressed concern about the issue are themselves unsure about how to proceed.

Under these circumstances, Congress might wish to go beyond its normal legislative procedure. It might consider establishing a mechanism allowing it to develop a comprehensive and strategic approach to HDTV in concert with the private sector and Executive Branch. Such a group might meet regularly with groups like the American Electronics Association that are developing business plans to commercialize HDTV, Department of Commerce officials charged with promoting HDTV, and other public and private officials concerned with HDTV development. Such ongoing joint work would encourage industry, allow legislation to adjust more quickly to quick-changing external circumstances, and avoid needless duplication.

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Recommendation #1 - Congress should promote an "industry-led" HDTV strategy by establishing a joint House-Senate committee to coordinate HDTV legislation and work on an ongoing basis with the Executive Branch and private industry on HDTV-related matters.

The kind of "industry-led strategy" needed to develop HDTV and other strategic industries should consist of at least four key components: (1) industry responsibility; (2) full government support; (3) overall strategic analysis; and (4) strong political leadership.

COMPONENT #1: INDUSTRY RESPONSIBILITY

During the last 10 years, America's economic policy can best be characterized as an attempt to return to a "laissez-faire" model that worked in an earlier era. This model basically sees America rely on individual U.S. companies to develop new products and industries, capitalized by venture capitalists, equity markets and banks (although government funding has played a far more important role in launching many key strategic industries than is often acknowledged. (7)) Government's role has been seen as limited to fiscal and monetary policy and removing burdensome regulation.

As described above, this "laissez-faire" model has now undeniably failed. It received the fullest possible airing during the past 8 years, and has contributed to rather than prevented the erosion of America's industrial base.

The fundamental reason "laissez-faire" has failed is that it has been unable to provide American companies with a cost of capital equal to that enjoyed by top competitors backed by the full resources of their banks and governments. It takes a long time to develop new industries and technologies. The Japanese, for example, have been been developing HDTV for 20 years. With huge cash reserves, Japanese companies can invest for 5, 10, even 20 years without showing a profit. American firms, however, are suffering from an estimated 4 to 1 capital cost disadvantage, and simply do not have the resources to make the same long-term investments. (8).

And, we must ask, if American companies have fallen so far behind during the past 6 years of recovery, what will happen during the next recession as cash-starved and debt-laden American companies are forced to compete with Japanese companies backed up by their government's net international surpluses? Clearly, continuing to rely on "laissez-faire" in the coming decade will spell disaster for any hopes that America can regain the industrial lead.

If "laissez-faire" cannot serve as a model for developing HDTV, however, neither can the kind of "industrial policy" which sees government become the key player in driving new products and industries. There simply is no consensus for a Japanese-like industrial policy in this nation.

What we need instead is to develop a new, uniquely American approach that combines America's entrepreneurial and innovative strength with a greatly increased level of public and

private resources that will allow this nation's companies to match the effort of our foreign competitors.

Some of us call such an approach "industry-led strategy" - an approach that would see industry take the initiative to join together and develop the new products and technologies of the future. The key here is to encourage industry to take responsibility for the effort, rather than relying upon government.

The major reason for this is practical not ideological. Government has played a major role in the past in developing industries like agriculture, housing, aerospace and semiconductors. As we look out over the coming decade, however, it is clear that virtually every industry in America is going to have to adopt new strategies to remain globally competitive. Taking responsibility for this is well beyond the capacity of a government that will be increasingly hard-pressed just to meet its societal, environmental and national security responsibilities.

America's future depends upon its private sector. At this stage, government's role should be to encourage business to change its industrial strategy, giving support where appropriate, rather than pursuing either a hands-off or overly interventionist policy.

We are already beginning to see early examples of such an "industry-led" strategy with the electronics industry's formation of the Microelectronics and Computer Technology Consortium (MCC), the semiconductor industry's initiative in forming Sematech, and the machine tool industry's National Center of Manufacturing Sciences. And industry members have begun to call for similar models in such areas as superconductors, optics and biotechnology.

Perhaps the most relevant model for how the U.S. can create an HDTV industry, however, presently lies in Europe. While many Americans would not be comfortable with the kind of an approach led by Japan's MITI or NHK television system, they would find the approach of Europe's Eureka Project far more compatible.

Eureka's HDTV effort is notable for three reasons: (1) leading European companies have taken the lead in developing an HDTV strategy, with governments playing an important but secondary role; (2) the breadth and scope of European HDTV efforts; (3) and the extent of coordination among nations, governments and companies.

Eureka's HDTV effort is several years old, and is presently estimated at some $200 million annually. It involves 26 companies and eight countries - Belgium, Finland, France, Germany, Italy, Spain, Sweden and the United Kingdom. Companies finance 60% of Eureka's HDTV efforts, governments 40%. (9)

Eureka's HDTV project has an overall project organization including a Directorate, Technical Advisory Panel and Commercial Advisory Panel. The Directorate's presidency is held

by the Philips Corporation, which also provides a full-time support team. Its vice-presidency is held by Thomson, and its other two members are Bosch and Thorne/EMI.

The heart of its work is its ten HDTV projects, each led by a company or public organization. These are: (1) fundamentals of picture and sound, psychophysics and subjective evaluation (CCITT, the international telephone union); (2) production standards and conversions (Thomson); (3) studio equipment (Bosch); (4) transmission (International Broadcasting Association); (5) HD-MAC encoding/decoding (Philips); (6) display standard and up-conversions (British Broadcasting Company); (7) receivers (Thorne/EMI); (8) carriers (Philips); (9) programme material (RAI, the Italian Broadcasting System); (10) bit-rate reduction (Thomson).

If America is to have a U.S.-owned and controlled HDTV industry, Congress will need to encourage similar cooperative efforts by America's private sector to develop an HDTV industry. As difficult as it may sound, this task should be far easier than Eureka's achievement in involving eight separate nations in their HDTV project.

In doing so, of course, Congress is sailing between the Scylla of doing too little and the Charybdis of doing too much.

On the one hand, organs of Congress like this Subcommittee and other branches of government like DARPA are to be congratulated for having taken so much initiative to develop an HDTV industry. It would have been unconscionable for an agency like DARPA to have sat on the sidelines and waited for an industry initiative before acting, and the DARPA HDTV initiative should be fully supported.

On the other hand, however, Congress should note that government initiatives like DARPA will succeed only to the extent that they are devolved over to, and institutionalized by, the private sector.

DARPA is taking an important first step in encouraging industry participants in its initiative to form an R&D consortium and strategic alliances between companies. But even if this R&D work succeeds in the next year or two, we will likely only have matched our foreign competitors in developing innovative technology. The real crunch will come when we move to the phase of manufacturing and marketing products. As we have seen, America has a long history of developing cutting-edge technologies only to see them produced for the mass market by stronger competitors.

In addition, as the European model shows, the development of an HDTV industry involves far more than the technology issues that DARPA is dealing with - including everything from programming and coordination with the entertainment industry to evaluating consumer response.

An industry-led effort is clearly needed now both to integrate technological developments with future manufacturing and marketing needs, and to look at the many other non-technology issues associated with HDTV development.

At present, the best hope for an industry initiative to take control of HDTV development is the American Electronics Association's 36-company effort to develop an HDTV business plan by May 1st, 1989. It is important that this effort be supported, and that industry know in advance that the U.S. government will give its business plan a favorable hearing. Industry should also feel overall responsibility for the DARPA initiative, and see it as part of its own long-term strategy.

The goal of such an industry-led HDTV strategy over the coming decade should be to develop a U.S.-owned and controlled HDTV industry that ensures that such HDTV components as chips and displays, and such related HDTV products as VCRs and computer monitors, are manufactured here by U.S.-owned companies.

The role of foreign participation in such a strategy is, of course, a thorny issue. It would be self-defeating to exclude foreigners from participation in an HDTV industry. Among other things, they have a technology lead in many areas, and it is in our interest to trade access to our market and industry for this technology.

It would be harmful, however, to give foreign companies control over America's HDTV industry. The argument that America's interests are guaranteed as long as foreign firms build HDTV sets in America is specious. Foreign control of an HDTV industry fails to guarantee that key technology information will diffuse out into American industry, jeopardizes the ability of American component manufacturers to win contracts, reduces long-term job security since foreign plants are often the first to be shut down in hard times, and makes this nation dangerously vulnerable to all manner of harmful business decisions over which we have no control.

American computer manufacturers believe, for example, that they suffered greatly in the past two years because they became dependent upon foreign chip-makers who discriminated against them. American semiconductor firms complain that Japanese computer printer manufacturers have responded to European demands that they increase European chip content by reducing the number of American rather than Japanese chips.

Our foreign competitors certainly do not believe that their interests are served so long as others build HDTV receivers in their countries. The reason that they lead in HDTV technology today is that they and their nations decided that it was in both the public and private interest for them to develop an HDTV industry. If we also are to reap the full economic benefits of an HDTV industry, we need to make a similar national effort. Ownership and control of a U.S. HDTV industry should lie with American firms.

One approach to ensuring foreign participation and U.S. control would be for Congress to move to establish one or more consortia that would be owned and controlled by U.S. industry. Legislation authorizing such consortia would make it clear that they would be free to fund foreign companies operating in the United States. Such an approach would apply to the design, development *and* manufacturing phases of HDTV production.

Once we have caught up in HDTV technology and committed to spending the billions needed to manufacture and market HDTV receivers and related products, however, we should be prepared to enter into "co-production" agreements with our top competitors. There is no point in engaging in a pointless "economic arms race" with them. Once we have reestablished ourselves, we should move to greater cooperation with them.

Recommendation #2 - Congress should encourage the American Electronics Association, or other interested parties, to produce a business plan to create a U.S.-owned and controlled HDTV industry that uses U.S.-made components to manufacture U.S.-owned HDTV receivers and related HDTV products.

Recommendation #3: Congress should prioritize providing matching funds to one or more U.S. industry-led HDTV consortia charged with creating a U.S.-owned HDTV industry. Such consortia could contract with foreign companies and, once the U.S. has re-entered HDTV as a full player, pursue co-production of HDTV products with them.

Recommendation #4: Congress should shift control of the DARPA HDTV project to industry over time, and seek to ensure that industry sees the DARPA initiative as part of its own long-term plans to create a U.S.-owned and controlled HDTV industry.

III. COMPONENT #2: FULL GOVERNMENT SUPPORT

Although U.S. industry must take the lead in developing a U.S.-owned and controlled HDTV industry, such an initiative is unlikely to succeed without the full support of the U.S. government.

The reason government help is needed is straightforward: only government can help U.S. companies achieve a cost of capital low enough to enable them to compete with foreign competitors enjoying a 4 to 1 cost advantage. The pricetag for creating a U.S. HDTV industry is enormous, and no American company or group of companies can mobilize this investment on their own.

While one cannot precisely estimate capital requirements right now, it is clear that billions of dollars of investment capital will be needed to create an HDTV industry using U.S.-made chips and other components. One must note that:

The Japanese are estimated to have spent $700 million to date on HDTV, the Europeans are presently spending $200 million annually, and they are still just developing the technology. Billions more will be needed to actually complete technology development, build manufacturing process technology, construct production lines, and begin manufacturing and marketing HDTV equipment. The U.S. may have to spend even more to catch up with our competitors.

In addition, the N.Y. Times reported on November 9, 1988, that 5 Japanese companies had spent an estimated $3 billion in just the last six months of 1988 to build new 1 and 4 megabit memory chip production lines, and to develop a prototype 16 megabit memory chip. The Electronic Industry Association of Japan has reported that 67.5% of their potential future chip production is meant for HDTV, intelligent work stations and 32-bit personal computers, all of which will increasingly resemble each other. (10) Gordon Moore, Board Chairman of Intel and President of the Semiconductor Industry Association, has said that American chip makers will have to make a similar "order" of investment to reenter the memory chip business. (11)

And many billions more will be needed to develop HDTV-related products from VCRs to computer monitors to video tapes.

Although we are now enjoying the sixth year of an economic recovery, no American company or group of companies can hope to attract this level of long-term investment capital for HDTV. And if, as is possible, U.S. companies will be called upon to pursue HDTV development over a coming decade that could feature a recession or worse, they will be even more hard-pressed to compete on their own.

This problem is aggravated, of course, by the fact that most U.S. companies have left the consumer electronics business and that some of the key computer and telecommunication companies which need to get involved for their own economic health - like AT&T, IBM and Apple - have no experience in consumer electronics.

The reasons that American companies are unable to compete with their competitors in raising long-term investment capital are well-documented, and include our high budget deficits and low national savings rate; excessive short-term pressures on corporate executives; the recent increase in debt caused by the rise in leveraged buyouts and corporate takeovers; and the fact that foreign companies enjoy far greater support from their governments and banks.

Ideally, as mentioned above, the U.S. government would address all of these issues, moving to reduce the deficit and excessive speculation, and create more long-term investment incentives.

But we cannot wait for these overall macroeconomic changes. We need now to also target assistance to HDTV and other strategic industries. Most of this assistance will be off-budget assistance that will help HDTV companies attract private capital, although some level of direct federal expenditures will be necessary.

The kind of government actions that need to be considered include:

-- direct R&D assistance, such as the DARPA program;

-- matching grants to industry-led HDTV consortia;

-- revising anti-trust laws to permit joint manufacturing and marketing, so as to remove fears that HDTV activity will be blocked by anti-trust lawsuits;

-- providing targeted R&D and other tax incentives for HDTV development;

-- targeting federal laboratory work on HDTV development;

-- extending low-cost government loans to companies involved in HDTV development; and

-- making guaranteed "buys" of early U.S. HDTV products through the Defense Department or schools, so as to allow HDTV companies to attract more private investment capital.

It may also be desirable, as Robert Cohen has suggested, to establish public-private leasing corporations, similar to what the Japanese have done with flexible manufacturing equipment, to help launch a U.S.-controlled HDTV industry.

To gain public support, such a government effort to fund HDTV development needs to demonstrate that it will be more successful than previous government efforts perceived as failures, such as government support of the synfuel industry in the 1970s.

The key to doing so is for companies developing HDTV to make a significant commitment of their own resources and personnel, as was done with Sematech when the semiconductor industry pledged $100 million a year - 50% of Sematech's cost - and some of their best people for the project.

The most appropriate level of government match, however, is less clear. In the case of Europe, as we have seen, industry supplied 60% of funds. In the case of Sematech, where there was a strong base of semiconductor companies with a long experience and stake in the semiconductor industry, a 50-50 match was appropriate. It may be that such a match is not possible in HDTV. Whatever the eventual match decided upon, however, the bottom line is that industry participants need to make a significant commitment of capital and human resources to HDTV development.

The most immediate government priority right now, of course, is for full funding of all worthwhile proposals made in response to the DARPA initiative. Since this is expected to exceed the $30 million presently available, Congress should act to ensure that full funding is allocated for worthy proposals.

The question of the long-term DARPA role in developing HDTV and other new industries, however, is a complicated one.

Using DARPA to spearhead industrial development obviously possesses certain advantages. DARPA has proven itself the only government agency capable of jumping in quickly and lauching the kind of catchup effort needed, and its personnel are to be admired for their skill, entrepreneurial attitude, and private sector experience.

Even more importantly, DARPA has greater potential access to needed funds than civilian agencies.

Between 1960 and 1980, Federal R&D spending was allocated 50-50 between civilian and military. From 1980 to 1988, however, military R&D spending was increased until it comprised 2/3 of Federal R&D spending. Should this nation seek simply to gradually reduce this ratio from 2-1 back to a 50-50 split over the next three years, and devote the added civilian R&D spending to civilian commercialization efforts, it would generate $45 billion for this purpose without increasing overall Federal spending.

Since the Defense Science Board has now found that civilian industrial spending is necessary to national security, there may be a new receptiveness in the Pentagon for increasing spending on civilian commercialization by transferring funds from military R&D. If so, it may prove easier to fund civilian R&D efforts out of DARPA than by attempting to switch these funds out of the Pentagon altogether.

But there are also obvious reasons why we should not rely totally on DARPA and seek instead to build up a capacity within the Commerce Department to develop the new civilian industries of the future.

DARPA's mandate, after all, is limited to providing support for technology development. And we cannot count on DARPA performing indefinitely in the future as it has in the past. Personnel change and priorities change. It is not impossible that a future defense funding crunch could see DARPA's ability to fund civilian technologies reduced rather than enhanced.

And, more importantly, it is the Department of Commerce that should be charged with integrating technology development into an overall commercial strategy including manufacturing, marketing and cross-linkages with other industries.

During spring 1987 hearings held by Senator John Glenn numerous experts - including Robert Noyce of Intel, Admiral Bobby Inman, former DARPA employee Robert Kahn and present DARPA employee Craig Fields - all called for creation of a new "civilian DARPA" to be housed in Commerce on the grounds that such an agency would be better equipped than DOD to develop civilian industries.

It thus seems desirable both to support DARPA's present HDTV initiative and to build up a capacity within the Commerce Department to promote civilian technologies and industries. DARPA is to be congratulated for setting up a cross-government committee to oversee its HDTV initiative. This committee should be institutionalized, and funds provided to the Commerce Department to begin to take responsibility for HDTV and other commercial development.

Recommendation #5:- Congress should provide full funding for all HDTV proposals that the DARPA authorizing committee deems worthy of support. Such funds should, as much as possible, come out of present federal R&D funding rather than new funding that would increase the federal deficit.

Recommendation #6: Congress should also make funds available to the Commerce Department to promote HDTV development, including funding industry-led consortia. Such funds could be allocated to the Advanced Technology Program of the National Institute of Standards and Technology, specifically authorized to fund technology consortia under last year's trade legislation, or to special projects dedicated to HDTV development under the authority of the newly created post of Undersecretary of Technology in the Commerce Department.

Recommendation #7: Congress should initiate meetings now with private industry and the Executive Branch to plan for any other government assistance that will be needed to create a U.S.-controlled HDTV industry - including revision of anti-trust laws and provision of low-cost government loans to consortia or companies, R&D and other tax incentives, coordination with federal laboratory R&D, and "direct buys" of early U.S.-made products.

IV. COMPONENT #3: STRATEGIC ANALYSIS

The creation of an HDTV industry is, of course, extraordinarily complicated.

The Europeans, as described above, have established 10 separate projects ranging from "fundamentals of picture and sound, psychophysics and subjective evaluation" to "production standards and conversions" to "programme material."

MIT expert Charles Ferguson has suggested that the United States see HDTV as only part of a broader digital technologies initiative that would cover such issues as fiberoptic cable networking, digital photocopy and facsimile equipment, graphics displays, CD-ROM systems, electronic cameras, and CCD scanners. (12)

Mr. Elkus has argued that we should end-use markets affected by HDTV include "programming (the media), telecommunications services including the broadcast industry, and audio visual communications equipment including telecommunications, transmission and distribution equipment, as well as cameras, Vcrs, and associated display technology." (13)

There is, in short, a growing consensus among experts that creation of a U.S. HDTV industry will have a significant impact on the consumer electronics, semiconductor, computer, office equipment, telecommunication and entertainment industries.

At present, the focus of U.S. private and public HDTV efforts are understandably on taking immediate measures to catch up technologically.

If we are to have a viable HDTV industry, however, we also need <u>now</u> to establish a capacity for looking out over the coming decade, and prepare for the interaction between HDTV and other affected industries.

Mr. Elkus, for example, argues that the President should establish an Office of Strategic Analysis to develop end-use market strategies rather than isolated technology developments, e.g. determining:

"A. Where the United States stands by end-use markets in relationship to the rest of the world. B. Where the United States stands regarding supporting products, components and technologies for those end-use markets. C. Which end-use markets in order of priority are most strategic in terms of interrelationship and interdependence with the economic and political goals of the country. D. What will be the projected effect on the U.S. economy and political system if current trends continue. E. To the extent that the United States' position in any of these end-use market and supporting products, components and technologies must be enhanced, what resources exist within the country to provide a basis for that enhancement." (14)

Mr. Elkus would then have the Office of Strategic Analysis make recommendations to the Secretary of Commerce, who would in turn meet with private sector parties who would take "action with respect to any desired change in U.S. participation in end-use markets."

Whether such a mission is best carried out by government officials or private sector executives is, of course, debatable.

Proposals for having government officials carry out this function include funding the Competitiveness Policy Council created in last year's trade legislation, and creating the Advanced Civilian Technology Agency proposed by Senator Glenn and Congressman Mel Levine, the National Technology and Policy Agency proposed by Congressman George Brown and Pioneer Magnetics chief Allen Rosenstein, a newly beefed up Office of Science and Technology within the White House, or a program under Commerce's newly-created Undersecretary of Technology.

Others might argue that such a capacity would best be carried out by private sector executives, either as part of a Commission or other quasi-government body, or entirely through the private sector. One intriguing possibility would to model such a body after the Defense Science Board. Located in the Commerce Department, for example, an Industry Analysis Board composed of top industry officials could make the same analysis of America's commercial needs as does the DSB of our defense needs.

Wherever it is located, however, it seems clear that any attempt to create a viable HDTV industry will require that the United States develop a capacity for long-term strategic analysis.

Recommendation #8: Congress should either fully fund the Competitiveness Policy Council, or create a Commerce Department Industry Analysis Board led by top business executives, to analyze our long-term commercial needs much as the Defense Science Board analyzes our defense needs.

V. COMPONENT #4 - POLITICAL LEADERSHIP

If America is going to commercialize HDTV and the other new industries and technologies of the future, it will require not only economic but political leadership.

The closest thing we have to a parallel for what needs to be done in the 1990s is the space program of the early 1960s. Many people and institutions played a key role in making the space program a success: Congress, NASA, the private sector, the scientific and engineering community, and many more. But one person above all stands out: the President of the United States.

It is theoretically possible to conceive of a scenario under which America could recapture control of the driving forces of economic growth without active Presidential leadership. Perhaps every industry in America will initiate Sematech-like proposals, Congress will provide the needed support, and we will get the job done without an Executive Branch focus.

It is far more likely, however, that active Presidential leadership will be required if America is to regain the industrial cutting-edge.

Part of the reason is the sheer magnitude of funding involved. Only the President has th power in our system to restructure incentives and provide direct funding and loans of the magnitude needed to support HDTV and other key industries in the 1990s.

But Presidential leadership is required for an even more important reason. The effort to regain leadership in HDTV and other future industries is far more complex than the space program. It involves far more industries, far more money and far more people. To succeed, it will require society-wide cooperation last seen during the second world war.

Under our system of government, only the President of the United States commands the resources, media attention and position capable of uniting the nation around a great national goal like regaining our industrial power.

What is required is that the President set his Administration's single highest priority on mobilizing America to regain the industrial cutting-edge.

Although it may seem naive to hope for this right now, there are some objective reasons for believing it possible:

-- the President has indicated that he understands the problem, although he has not yet set a priority on mobilizing the nation to meet it;

-- his Administration has not yet set its priorities, and is under strong pressure to do so; and

-- there is evidence that such a priority would benefit the President politically.

Voters around the nation, for example, have given strong support to governors who campaigned for initiatives to improve their states' competitiveness - even to the extent of rewarding Governors who proposed higher taxes for goals like education and economic development.

And though many leaders avoid discussing America's eroding world position for fear of being accused of "gloom and doom," there is growing evidence that the American people already understand our problem. A recent Washington Post-ABC News poll, for example, reported that Americans today believe that Japan not America is the world's leading economic power by a 54-29 margin. Americans know we are in trouble, and will not punish politicians who tell them the truth - they simply want answers to our problems.

A useful book by Professor John Logsdon, entitled The Decision to Go to the Moon, recalls what occurred in the spring of 1961 when a newly elected President found his himself bogged down in the aftermath of the Bay of Pigs invasion and Yuri Gagarin's successful journey into space. (15)

That President decided to refocus his Administration. On May 25, 1961, John F. Kennedy called a special session of Congress and, in one of the memorable moments of his Presidency, launched the space program.

Is it too much to hope that today the members of this Commitee might convince Congress's leaders to make industrial revitalization their top priority? And might Congressional

leaders then convince our new President to do so, perhaps announcing it to a joint session of Congress on May 25th, 1989, the 18th anniversary of John F. Kennedy's historic speech?

I do not know, of course. But I do know this: only such bold political leadership from Congress and the President can save us from generations of decline. Without such vision our future is in jeopardy. We owe far more to ourselves, our children, and to all those who will come beyond them.

Thank you.

Recommendation #9 - Congress's leadership should set its own top political priority on developing a comprehensive initiative to restore America's industrial strength. Congressional leadership should in turn encourage the President to make this his highest priority, following the model set by John F. Kennedy in launching the Space Age in the spring of 1961.

Mr. MARKEY. Thank you very much, Mr. Branfman.

Our next witness is Professor Jeffrey Hart from the Berkeley Roundtable of International Economics, University of California. Welcome, Mr. Hart.

STATEMENT OF JEFFREY HART

Mr. HART. Thank you, Mr. Chairman.

I am actually Professor of Political Science at Indiana University in Bloomington, and I am visiting scholar at the Berkeley Roundtable on the International Economy, which is a small university research group devoted to the study of the interaction between technology, business strategy and government policy.

I began to study HDTV as an issue with a short report that we did for the Office of Technology Assessment of the Congress on what happened to the U.S. consumer electronics industry, and with some attention to how the United States could reenter consumer electronics if possible, and HDTV came up as a prime vehicle in that study.

I also participated in the American Electronics Association Task Force on Advanced Television and helped them prepare their report on the projections of the impact of different levels of U.S. participation in the HDTV markets of the future. We also work with the Semiconductor Industry Association on their efforts in trying to understand the relationship between semiconductor industry and the emerging HDTV industry.

Finally, I participated in the Electronic Industry Association's Committee on HDTV, which prepared a submission for this committee and which, in fact, I co-authored with Laura Tyson in earlier drafts for the EIA. They removed some of the prose that we gave them, but nevertheless it is quite close to our original report to them.

In the future I will be working with the National Center for Manufacturing Sciences in Ann Arbor on the implications of HDTV for U.S. manufacturing. So I come to this subject with a long-term research interest but with a lot of experience with many sides of the industry, many different views, especially within the manufacturing end of this issue.

The key issues that I addressed in my written testimony, and I won't go into detail here, have to do with whether HDTV is the appropriate vehicle for U.S. reentry in the consumer electronics markets. The assumption behind that question is that reentry into consumer electronics markets is important for exactly the reasons that Mr. Prestowitz outlined before, that is, U.S. weakness in consumer electronics hurt the U.S. competitively in electronics.

We all seem to believe that electronics, and particularly microelectronics, is a strategic industry for the United States, not only in the sense that it is large but also that it has important linkages or spin-offs to the rest of American manufacturing and probably to the American economy as a whole, including the services sector.

So that the sort of chain of logic in our analysis is that there is a problem of U.S. competitiveness; that within that problem of U.S. competitiveness, we have a strong electronics complex which is vital to maintain or even increase its strength as part of overall

U.S. competitiveness efforts. The revival or reentry of consumer electronics can help to maintain or increase our competitiveness in electronics, and HDTV may be a vehicle for reentry into consumer electronics. So that is kind of the logical chain.

By that same token, because there is this chain of logic to our argument, there is the question as to how much power you lose at each level. That is, how much of a lever into entry into consumer electronics is the HDTV, future HDTV industry? How important is consumer electronics to electronics as a whole, and how important is electronics to the rest of the economy? Those are all issues that need to be considered in talking about the general approach to competitiveness which is engendered in the HDTV issue specifically.

Also, we are taking the position generally speaking that there needs to be economy-wide measures as well as industry-specific measures in this area. Economy-wide measures are important to reinforce what you do at the industry level, and without doing things at the industry level, you may not actually be able to do something positive about reentry into consumer electronics. So we are trying to put forward a position which mixes economy-wide or macro-economic measures with industry specific or what you might call meso-economic approaches, Meso because it's not micro. You are not dealing with taxes or individual consumer behavior; you are dealing with industry, industry groups.

Now, I won't go into any further detail but I did want to use the rest of my time to try to talk about what I got out of the action memos for the committee. In a sense that was part of our mandate for this hearing. I did see basically three ways of talking about that. One is that there was an emerging consensus on issues that you can see across the entire range of submissions. Second, there were differences, fairly important differences, and therefore that leadership would be required if things had to be done in those areas where there were differences.

I think I will finish this oral statement with some ways that I think that the Congress and the rest of the Government may exercise leadership both in the areas of consensus and in the areas where there are differences.

In the area of consensus it seems to me fairly clear that the idea of public/private support with matching grants and perhaps minority shares, as Professor Flamm has suggested, for R&D consortia is fairly well supported across all the groups and all the interests.

Second of all, there seems to be a fairly broad consensus on maintaining compatibility with existing NTSC receivers. There are about 140 million TV sets out there. You don't want to have a system, at least in the short term, that obsoletes all those receivers. You might, however, want in a 10-year period to phase out NTSC broadcasting because people historically have held onto their TV sets for 10 years. It may very well be, and the engineers tell us that sticking to NTSC backward compatibility may very well handicap the development of a real HDTV industry. If that is the case, I think it would be wise then to grandfather in some way NTSC signal broadcasting or delivery.

In one of our more daring proposals in the written statement, we say phase out over-the-air broadcasting in 10 years, which would

have very much the effect of accelerating of the building of a broad band telecommunications network in the United States and would also allow all the various ways of delivering the signal to work out their own ways in much more efficient and probably more digital ways of delivering the signal than is currently happening, and therefore more error-free ways of delivering the signal.

I see also a fairly strong consensus emerging on economy-wide measures, particularly for the relaxation of antitrust restrictions, and I am not quite as skeptical as Ken Flamm is on this issue. I think most of the people support relaxation of antitrust restrictions on R&D consortia. Only a few of the players seem to be worried about restrictions on production consortia or commercialization consortia, and I think the Congress needs to be skeptical about moving down the chain toward production and commercialization and relaxing antitrust restrictions.

There are reasons in the HDTV case, because of the extreme weakness of the American consumer systems industry, to think about possible exceptions for the case of this industry, but I think one has to be very vigilant about that and very careful to define it in such a way that production consortia or commercialization consortia don't undermine the overall antitrust regime that has really been such a boon to American competitiveness in the long term.

Second of all, I think there is a very broad consensus on enforcing existing trade laws, and particularly the Omnibus Trade Bill of 1988 provides us with lots of mechanisms to deal with the problems that we have had in the past with lax enforcement of anti-dumping and other unfair trade practices. So that seems to go fairly widely.

There is also, I think, and not talked about very often, this question of trying to open foreign markets to U.S. exports. There is support for changing the tax laws in a variety of ways, including making the R&D tax credit permanent, including general investment tax credits, including graduated capital gains tax. all of which would have the effect of raising investments in the United States, particularly in process technology.

Mr. MARKEY. I would ask if you could try to summarize in 30 seconds, please.

Mr. HART. I would be glad to.

I think in the areas of leadership there are some real problems indicated in the action memos. One of them has to do with the fact that I think the main sources of the differences I could see there were that these different actors have very different economic interests, and in particular this question of which medium for delivery is the best medium for delivering HDTV signals seems to be a major source of differences; the question of open architecture, the question of friendliness of signals across media, timing of the standards and the choice of specific production and transmission standards.

I don't think you can expect these actors to agree on these issues, but there is, I think, a good case for the Congress and the Government generally to try to maximize the spin-offs from whatever the Government does in HDTV to promote U.S. participation in HDTV. One thing that it really can do that I think is very important is to make sure that both in the area of semiconductors and

the area of broad band telecommunications, we get the biggest bang for the buck out of whatever we do in HDTV

Thank you very much.

[The prepared statement of Mr. Hart follows:]

STATEMENT OF JEFFREY A. HART

Reentry in consumer electronics is vital for two main reasons. First, consumer electronics products drive the creation of high-volume, low-cost production of leading-edge components. Such components have broad application throughout the entire electronics industry. Second, the mass production associated with consumer electronics can be used as a proving ground for innovations in electronics materials, equipment and manufacturing techniques.

Until relatively recently, U.S. participation in the consumer electronics industry did not appear to be crucial to its economic strength. U.S. firms have had a comparative advantage in other, more capital- and knowledge-intensive industries. In particular, U.S. firms created a strong technological base for themselves in digital technology. They tended to restrict their R&D investments to computer, telecommunications, and military electronics, where the returns on investment were more secure than in consumer electronics. Poor enforcement of trade laws combined with unwise strategies on the part of traditional consumer electronics manufacturers translated into a nearly universal exit from consumer systems markets. A small number of U.S. firms held on as suppliers of advanced circuitry to Japanese consumer producers, but the production of consumer circuitry generally followed the production of systems in leaving the country. This was probably not so important with the NTSC television systems of the mid 1970's and earlier, as the types of circuitry required were highly standardized and mostly analog devices, with few applications outside of consumer electronics.

With the introduction of VCR's, video cameras, LCD televisions, and CD players, a new era of consumer technology came into being. The electronics circuitry in these systems was more complex and increasingly utilized digital techniques to supplement the traditional analog approaches used in television and radio. Japanese firms, in particular, were fast to introduce digital circuitry into traditional consumer systems as a competitive strategy for differentiating products. They were successful in securing virtually unassailable competitive positions in the higher-value-added products that resulted.

With the introduction of HDTV products, it will become even more necessary for the U.S.-owned firms to regain a position in consumer electronics markets in order to safeguard U.S. competitiveness and national security interests. It is no longer the case that consumer circuitry bears no relationship to the circuitry that is needed for computers and telecommunications equipment. HDTV product development will push out the technological frontier in such important areas as analog/digital converters, digital signal processors, video image processors, decoders/encoders, and broadband switching circuitry.

Because consumer products tend to have shorter and shorter life cycles and because of the need to compete with producers in low-wage countries, flexible automation is crucial for the economic survival consumer electronics system firms in high-wage regions. Japanese electronics firms have been far in front of U.S. firms in the introduction and diffusion of automated insertion equipment and surface mount technologies for assembling printed circuit boards. They have been much more ambitious than U.S. firms in introducing reprogrammable robots and computer-integrated manufacturing in their consumer electronics operations. The Japanese are ahead in the automation of bonding and packaging in the assembly of semiconductors as well. U.S. non-participation in consumer electronics production has meant that U.S. firms have not had to wrestle with the exigencies of flexible high-volume production.

If the United States is serious about securing a bigger share of world consumer electronics markets, then it must adopt a strategy to neutralize the substantial Japanese advantages in components and systems manufacturing technologies.

To say that U.S. reentry into consumer electronics will be difficult is an understatement at best.

Zenith is the only U.S.-owned firm that still produces mainstream consumer systems like televisions. There are other U.S.-owned firms which produce consumer items, especially if one includes personal computers and PC peripherals as belonging in this category. For example, Motorola produces telephone pagers, Hewlett-Packard makes printers and terminals, and IBM makes printers and typewriters. A

growing number of small firms are supplying NTSC video-imaging boards for use in PC's. But Zenith, because of its role in television, would have to be part of any U.S. strategy to increase its participation in consumer electronics via HDTV.

Zenith is in weak shape, financially and technologically, to be an adequate base for the building of a U.S. HDTV reentry strategy. Zenith's consumer electronics operations have been unprofitable since 1985. Only its diversification into a profitable PC business saved it from bankruptcy or acquisition. In the last 2 years, rumors have abounded about imminent takeovers by European or Asian firms. Wall Street investors have put strong pressures on Zenith management to sell off the consumer business in order to improve the overall profitability of the firm. Because of the low profits in televisions, Zenith has been unable to invest sufficient amounts in R&D to keep up with its international competitors in developing HDTV technologies. One of the reasons why Zenith approached DARPA recently with a proposal for DOD funding for the upscaling of its FTM (flat tension mask) monitor was the lack of internal funds to do this on its own.

Because of the dominance of European and Asian firms in consumer systems and because of the higher profits available in other areas of electronics, U.S. semiconductor firms are weak in the design and production of consumer circuitry. Even Zenith does not source its components from U.S. firms, but rather primarily from ITT (Europe) and Matsushita. Similarly, both Thomson and Philips source consumer chips primarily from European and Japanese semiconductor firms. Thomson sources primarily from ITT (Europe) and Oki.

Consumer systems market in this country are already crowded. There are already six Japanese firms producing televisions, two European, one U.S. and two Korean firms. By contrast, only the Japanese and Korean firms have access to the Japanese market, and access to the European market is similarly restricted.

The structure of the U.S. electronics industry is more fragmented than that of either Japan or Europe. This means that several layers of U.S. firms must cooperate to effectively reenter the market, especially given the inevitability of continued competition from foreign manufacturers. It may be necessary to forge alliances among firms in a number of industries, including semiconductors, telecommunications, computers and automotive electronics. (Although these industries are still relatively disparate, they are moving in converging directions with regard to production components and technologies.)

Despite the obstacles, reentry is not impossible. U.S. firms continue to show strengths in some areas of electronics, especially computers, automotive electronics and telecommunications. As discussed above, each of these industries utilizes technologies that are increasingly related to the next generation of consumer systems. While cooperation and utilization of existing strengths will be necessary for reentry into consumer electronics, it may not be sufficient. Successful reentry will also require government policies to overcome existing industrial weaknesses.

However, it is important to recognize to recognize that any attempt at reentry will probably be unprofitable, at least in the short run. This alone will deter some American manufacturers from expending the necessary resources to begin producing consumer systems. Because of the U.S. weakness in consumer systems, it will be necessary to establish cooperative arrangements with foreign-owned firms operating in the United States in the short to medium term, so as to establish a technological and manufacturing base for more autonomous development efforts later.

The most likely partnerships will be between the two European systems firms, Thomson and Philips, and U.S. semiconductor producers. In certain very specific areas, such as LCD's, it may be prudent for U.S. firms to cooperate with the weaker Japanese firms. The main problem with U.S.-Japanese partnerships in consumer electronics is that the Japanese firms, for the most part, do not need help from the U.S. firms. In the long term, there have to be new entries by U.S.-owned firms into consumer systems markets to make U.S. reentry into consumer electronics self-sustaining.

Reentry into consumer electronics markets will require a specific vehicle, that is, a decision to focus on a particular consumer product. High definition television should be that vehicle. Because HDTV incorporates sophisticated integrated circuits and memory capacity, production of HDTV receivers would provide a significant source of demand for those components. Moreover, the rapid diffusion of HDTV is likely to require changes in the way that video signals are transmitted to homes. The most effective ways of delivering HDTV signals to households will be via broadband media such as optical fiber and satellites. The use of broadband media for the delivery of HDTV signals may speed the building a national broadband telecommunications network which could be an important infrastructural underpinning for the overall growth and competitiveness of the U.S. economy.

Given the enormous potential of HDTV technology, as well as obstacles facing potential producers, what type of strategy should the United States adopt if HDTV is to help the U.S. industry regain its competitiveness in consumer electronics? In formulating the specifics of such a strategy, policymakers should keep six general guidelines in mind.

First, business strategy should determine the choice of technologies to support, rather than vice versa. This is a fundamental point if U.S. firms are to establish a self-sustaining presence in those parts of the consumer electronics business that contribute to industrial and military strength. Anything else will require enduring subsidies and will likely fail to keep pace with foreign technical advances. Thus, self-sustaining presence can only be built through successful commercial strategies—not through defense-led technology development.

Second, the business problem must be defined as the need for U.S. industry to capture a significant share of HDTV and related markets. The strategy adopted must identify the policies that are necessary to achieve this end, including the appropriate roles for government and industry. Moreover, several terms must be carefully defined within the context of a coherent strategy—including "HDTV-related markets," "U.S. industry," and "significant share."

Third, the strategy adopted must identify key industrial and governmental players. Moreover, it is important to identify appropriate sources of funding and the organizational forms that will be necessary to achieve market and technology goals.

Specific policies must be adopted in a number of key categories, including R&D, trade, antitrust, standards, regulation, fiscal and monetary policy, education and training, and procurement.

Fourth, a strategy is necessary to compensate for advantages that foreign firms derive from their more highly integrated firms and less competitive regional markets. There are a number of ways to do so. For example, consortia could be formed around a U.S.-owned consumer systems champion for development of new HDTV technologies; since Zenith is the only U.S.-owned systems firm it would become the "consumer champion" by default. Alternately, U.S. firms could enter into ventures with foreign firms that are strong in consumer systems but weak in components production (for example, European or Korean firms).

Fifth, while those two options are both viable in the short run, neither will be a long-term, self-sustaining option in consumer markets unless three other options are also adopted: (1) industries could form consortia for the joint production of receivers; (2) large companies like IBM and AT&T could enter HDTV production on their own; and (3) Small start-up firms could enter specialized niches in the HDTV market with "open architecture" systems.

Sixth, any U.S. strategy for a self-sustaining presence in consumer markets will require the fortification of intellectual infrastructure through education and research. Universities can play a vital role in this effort. Similarly, there must be efforts to develop skills at the secondary school level—for example, through initiatives in vocational education.

Keeping the above the general principles in mind, let us turn to a number of specific policy options that are designed to promote a self-sustaining U.S. presence in consumer electronics via HDTV reentry. (The options presented in this section assume that it is not necessary to adopt changes in policies that affect the economy as a whole. That assumption will be reexamined in the next section.)

All policy interventions carry with them some risk of making things worse. For example, there have been few examples of successful military funding of commercial technologies in recent years. A frequently cited example of ill-conceived efforts is the VHSIC (Very High-Speed Integrated Circuit) program. While Sematech provides a precedent for joint public and private funding of consortia, it may not prove to be a useful model for what is to be done in consumer electronics.

Consequently, the following proposals are presented in a deliberately provocative manner in order to generate a serious discussion of public policy options—those that provide something beyond incremental decisionmaking.

One ambitious long term proposal would have the Federal Communications Commission mandating that all over-the-air broadcasting be phased out in a 10-year period. At the end of that period, all VHF and UHF spectrum would be reallocated for cellular radios—perhaps with the possibility of allocating cellular broadband for portable video applications. This would have the effect of speeding both the diffusion of HDTV equipment and the construction of a national fiber network.

An equally ambitious long term option would be for Congress, the FCC and other agencies to encourage the RBOC's and the Cable TV operators (or their future counterparts) to provide each household with a 600 Megabit/second optical fiber link to the national fiber network. Households would be permitted to add other equipment

to the fiber connectors, including more sophisticated HDTV devices. The cost of paying for the link to households (approximately $150 billion) could be shared between video service providers, telecommunications service providers and consumers. Government policy would encourage RBOC's and Cable operators to compete in providing video and telecommunications services to households.

A more focused long-term proposal would establish priorities for public and private funding of R&D consortia. The four areas that should receive top priority are displays, digital signal and video image processing circuitry, broadband switching, and consumer electronic manufacturing technology. While the current DARPA focus on displays and display circuitry is important, it runs the danger becoming blindsided on the telecommunications aspects of HDTV and manufacturing. The implications for consumer electronics should be kept firmly in mind.

In addition to the above long-term proposals, two more immediate proposals can also be made. For example, DARPA and other public agencies could fund the development of HDTV prototype equipment in order to minimize the time required to adopt a distinctive U.S. HDTV standard. Requests for proposals would be designed with an eye to helping the United States incorporate technological advantages into products and maximize the scope of spinoffs to related electronics endeavors.

Another short-term proposal would be to reexamine existing programs with an eye toward slight changes that would help promote participation in HDTV markets. DARPA, the National Science Foundation and other public agencies would evaluate such programs (for example, in multiprocessing or broadband switching) with regard to the ways they relate to a national HDTV strategy. Managers of these programs would be educated about the importance of the United States' reentry into consumer electronics. Wherever it is possible to generate important spinoffs for HDTV technologies—for instance, through a minor reorientation of the terms of the project—this should be done. Special effort should be made to assure that the results of these programs are widely diffused among U.S. firms.

The policies described above would not involve any fundamental changes in U.S. macroeconomic or regulatory policies. However, judicious changes in economy-wide policies could provide an underpinning for the success of the industry-specific policies already discussed. These changes include: (1) making the R&D tax credit permanent; (2) relaxing restrictions in the National Cooperative Research Act of 1984; (3) adopting a graduated capital gains tax to increase the rewards to firms making investments in new capital equipment; (4) shifting the composition of Federal spending toward education and worker training, infrastructure, and commercial science and technology, and (5) establishing a national commission on technology to establish priorities for future public funding of R&D consortia.

Mr. MARKEY. Thank you very much.

Our final witness is Mr. Robert Cohen, who is the Senior Economist at the New York State Urban Development Corporation, representing the Economic Policy Institute, which includes major American economic thinkers like Lester Thoreau, Bob Reich, Robert Cuttner, Barry Blustone and many others.

Mr. Cohen will announce a major new study concerning the potential trade impact and jobs impact if the United States is not a major player in HDTV, and I believe Mr. Cohen and the Economic Policy Institute are to be commended for their work in focusing on this issue. I would like to introduce you right now and welcome you.

STATEMENT OF ROBERT COHEN

Mr. COHEN. Mr. Chairman, I submitted the study or the synopsis of the HDTV part of the study for the committee to your counsel, and I also today gave him a commentary on the recent legislation that was introduced by Congressmen Ritter and Levine.

What I would like to stress is that using figures that were originally derived from the American Electronics Association study, I have calculated that the United States could face an annual trade deficit of more than $225 billion in electronics, including high definition television and related industries, personal computers, auto-

mated manufacturing and semi-conductors by the year 2010. We would also lose more than 2 million jobs each year if we fail to develop a strong high definition television industry and related flat display screen technology industries.

The trade deficit under a weak HDTV scenario where the U.S. industry takes only 10 percent of the world market would be $227 billion in year 2010 for just these four industries alone. That is compared to our present trade deficit of about $180 billion for all industries in total. The main contributors to the enormous trade deficit at 2010 would be the personal computer and semiconductor industries, which would suffer estimated deficits of $114 billion and $76 billion, respectively.

I think HDTV is here today and is an opportunity that we can either seize or lose. More importantly, I think the Congress needs to recognize the difficult straits that the electronics industry is currently in. If the U.S. doesn't redevelop some form of an electronics industry with greater vertical integration and internal competition, we will be likely to lose our entire micro-electronics sector.

As of today, we have no known U.S.-owned and controlled source of silicon wafers for our entire industry, although some firms have their internal capabilities. In addition, we have no U.S.-owned or controlled source of ceramic packaging for avionics and space applications for commercial and defense purposes. In addition, one of the three companies on the leading edge of the high definition technology, Alphasil of Freemont, California, is on the verge of going bankrupt.

HDTV is an area which will, in my mind, be the key technology of the next 20 years because of its impacts on related sectors. As I emphasize in the briefing paper, these linkages create a food chain which is quite significant and basically runs through the entire economy. I would like to just digress and give you a brief picture of how I see this technology working.

Within the next 5 years as we move toward HDTV, we will probably continue to use cathode ray tubes, the large tubes that you see in TV's today, moving up to 32 inch or greater screens. As we move out to 1995, it is clear, according to most of the people that work in this field, that the technology will necessarily shift and the cathode ray tubes will be a thing of the past and that we will need to move to high density television using high resolution displays.

This creates an entirely new opportunity in terms of technology and economic development because high resolution display systems will be derived not only from HDTV but will be used for personal computers, work stations, communications, TV and media presentations, high resolution graphics and art, and have wide applications throughout the economy.

To give you a couple of illustrations of how useful this technology is when it moves to a digital imaging system rather than an analog one; if you are in a situation where you are doing air traffic control at present, it is highly difficult to identify each plane that is coming in, its speed, its trajectory, and so forth. With a high density system, you can do this. If you are in a battle scene situation and there are 50 things incoming, at the present time they show up as one blot. With HDTV you could identify each one and know exactly what their trajectory was.

So not only would civilian uses be greatly enhanced, but also defense purposes would be greatly served by this technology. That can also be extended to move into medical and health uses, into educational uses and so forth. I think we ought to also be clear that there are great industry applications. You could add artificial intelligence systems to manufacturing devices that are linked to these high resolution display systems and control manufacturing processes in a steel mill, in an auto company, in a pharmaceutical company, much more directly than is possible with technology that is in place now.

So that this technology sweeps through all other American industry and is not just a television technology. It applies also to how well we will be able to compete in manufacturing industries and probably in service industries, too.

So I think this is a vast opportunity, but I think we have to be clear about what our competitors are doing. It surprises me that information is contributed to the hearings, such as contributions from the Electronics Industry Association, and the testimony yesterday of Secretary Mosbacher that makes no mention of new initiatives that are being undertaken by our competitors.

Just this last December, the Japanese announced that they, under MITI's key technology programs, were initiating a $700 million, 5 to 7 year program to improve Japanese development of high resolution display screens. This is for screens alone, and according to estimates that I did last summer for a Department of Commerce Study of the electronics industry, I think this basically doubles the annual contribution of the Japanese government to the development of HDTV and related technologies.

One of the things that I think is becoming clear is that this sort of promotion from the government sector, particularly in Japan and also in places like Korea, is going to put our industry even further behind if there is no assistance in the United States. For example, at the present time, both Japan and South Korea have their firms investing $6 billion a year in new semiconductor fabrication facilities. Our Nation's investment in this area is not even close to that total.

So the control over volume production, which is really the key to driving competitiveness in this area, is shifting to Asia and away from the United States. I think we ought to be concerned, in addition, because it's not only the cartel arrangements, but also the cost of capital of playing in this industry that is so critical. If you look at steps that have been taken, one of the key things that was done by the Japanese initially was to agree that MITI and their Ministry of Finance would direct Japanese financial institutions to make funds available to the electronics sector at preferential rates.

Today, if one looks at the cost of capital in all of Asia, companies in this industry are paying only 0 to 2 percent for their capital. Companies in Europe are paying roughly 2 to 4 percent for their capital. Companies in the United States are paying prime plus 2 or prime plus 4 percent. So it's not just the cartel arrangement that has made it difficult for our industry to compete, it's also the cost of capital.

The fact that the tax bill of 1986 revised R&D tax credits also creates difficulties for our firms to become more competitive. I

think the other thing that needs to be appreciated given this development of technology is the sort of linkages that the development of high definition television and high resolution displays create throughout our economy. This base, which represents a sort of food chain in electronics, is particularly critical and it's created when there is a demand for basic components, such as semiconductors and digital display screens, as a result of a more competitive high definition television and high resolution display system development and commercialization in the United States.

HDTV's could be used in the home. They will be display screens for personal computers. The Nation's businesses will use them to improve controls over automated production. They'll be able to integrate video and print media in newspapers. They'll also have applications in the collection and transmission of important medical results, such as x-rays and computer tomographs.

In conclusion, I want to emphasize that the United States stands at a critical juncture that will shape the growth of not only our electronics industry, but also our industrial base into the next century. Since the new industries of high definition television and flat display screens are likely to have an enormous impact on our electronics industry, the fact that we have lost much of the consumer electronics base may lead some to minimize the impact of the new digital revolution.

This revolution offers the potential for dramatic revival of industries that could form the base for the creation of at least two million jobs and a gain our trade account of over $225 billion in the year 2010. Given the strong government role played in promoting the development and commercial success of these industries in Europe and Japan, it's no longer logical for our policies to avoid supporting these industries that are critical to our future growth.

If we continue to lose the skill jobs and the innovative spirit of entrepreneurship that has supported the vitality of the U.S. electronics industry since its inception, our economy will be subject to pressures that will cause substantial dislocation of industries and workers as we settle for a position as a branch-plan economy.

[Testimony resumes on p. 239.]

[The prepared statement of Mr. Cohen follows:]

STATEMENT OF ROBERT COHEN

The US could face an annual trade deficit of more than $225 billion in electronics and lose more than two million jobs a year by 2010 if it fails to develop strong HDTV and flat-display screen industries. The trade deficit under a weak HDTV scenario, where the US industry takes only ten percent of the world market, would be $227 billion in the year 2010 for just four electronics industries: HDTV receivers and VCRs, personal computers, semiconductors and automated manufacturing equipment. The main contributors to this enormous trade deficit would be the personal computer and semiconductor industries, which would suffer estimated deficits of $114 billion and $76 billion, respectively.

As a result of this trade deficit, the US would lose 792,000 jobs in these four closely linked industries, since weakening the HDTV base weakens demand and technical innovation in the other electronics sectors. An additional 1.5 million jobs would be lost through the loss of spending in the economy by people who would have been employed in these electronics sectors. These multiplier effects are based on a rather conservative estimate of approximately two new jobs for every new one in electronics.

As these figures show, our nation stands at a critical juncture. If we do not create a strong industrial base centered on development of HDTV and flat-display screen technology, it will not only weaken our industrial base, but also reduce the numbers of skilled jobs that are needed to make us more competitive.

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[1]This report is taken from a larger study-in-progress, *Telecommunications Policy and the Emergence of High Definition Television*, to be published by the Economic Policy Institute.

LINKAGES: ONE KEY TO CREATING COMPETITIVENESS

Why would our failure to develop a strong HDTV industry have such a dramatic impact on the trade balance and job creation? Because the HDTV and flat-display screen technologies are intimately linked, economically, to the improvement of our personal computer and automated manufacturing industries, which are likely to expand at a rapid pace during the next two decades. These linkages--through which improvements and expansion in one electronics sector stimulate improvements and expansion in others--are critical to the future development of our industrial base.

When a personal computer adopts the kind of flat display screen associated with HDTV technology, it will not only create additional demand for the products associated with this new industry, but it will also require a large number of semiconductors to support the new projector and display technology that will be incorporated in the screen itself. The use of these inputs will give a boost to demand for products from these related industries, contributing to increases in their output and improving the chances that they will be profitable and have the funds to support further innovation.

These linkages create a kind of feed-back mechanism that provides its greatest advantages to our industrial base when the entire "food chain" of the electronics industry is improved. This will occur when the demand for basic components, such as semiconductors and digital display screens, is expanded to a wide range of applications of the final products in our economy. HDTVs will be used in the home, as display screens for personal computers, and by the nation's businesses to improve controls over automated production in auto, steel and manufacturing plants, to integrate video and print media in newspapers, and for the collection and transmission of important medical results, such as x-rays and computer tomographs.

THREE SCENARIOS FOR US ELECTRONICS INDUSTRIES, 1990-2010

So strong are the linkages in the electronics "food chain" that industry experts believe they can project US production and market shares in both upstream and downstream industries, based on various scenarios for the introduction and success of an emerging technology such as HDTV. This study bases its estimates of trade and employment impacts in the year 2010 on production and US market share scenarios developed in a study recently released by the American Electronics Association. The underlying data from that study are shown in the Appendix Table.

According to the AEA study, the Strong scenario represents a case where 50 percent of the US market for HDTV is controlled by US firms. In the Medium Scenario, 30 percent of this market is controlled by US firms, and in the Weak Scenario only 10 percent of the US market is controlled by US firms. According to these unadjusted estimates, with a strong HDTV base, the US PC industry would attain an estimated $221 billion in sales, in contrast to an expected $110 billion in sales with a weak HDTV sector, a difference of $111 billion in foregone sales if the US has a weak HDTV base. The contrast is almost as striking for the semiconductor industry. In this sector, sales would reach an estimated $124 billion with a strong US HDTV sector and only an estimated $62 billion with a weak HDTV industry, a difference in 2010 of $62 billion in semiconductor sales.

These figures are adjusted in Table 1 using estimates for how much of the total US market share would be produced in the US (as opposed to US owned offshore facilities). This permits us to create projections for US based production under each of the three scenarios for the year 2010. These estimates can be used with projections of total US sales to compute the trade surplus or deficit that would be expected under each scenario in 2010. As can be seen in Table 1, the differences between the Strong and Weak HDTV scenarios are striking, particularly for the personal computer

and semiconductor industries. In the case of the PC industry, US production would reach an estimated $176 billion in 2010, while it would only be an estimated $44 billion under the weak HDTV Scenario. For semiconductors, US production would grow to an estimated $ 99 billion under the Strong HDTV scenario but only $25 billion under the Weak HDTV scenario.

While these differences are quite large, they are not surprising. If the US HDTV industry generates little local production and only a small amount of innovation in electronics products, it is very likely that even the largest US companies will obtain many of their components overseas, earning profits by the value added that they gain from assembling the components into a computer or automated manufacturing equipment.

Table 2 sums up the trade impacts of the different scenarios in 2010. It shows that the trade balance in these four industries would range from an estimated surplus of $10 billion to an enormous estimated deficit of $227 billion in just one year. The main contributors to this deficit would be the personal computer and semiconductor industries, which would contribute deficits of $114 billion and $76 billion, respectively, to the overall trade deficit under the Weak HDTV scenario.

Employment impacts can be obtained by dividing the sales figures in Table 1 by the amount of sales that we would expect these industries to have per employee. There are currently about $150,000 in sales for each employee in the computer and telecommunications industry in 1987. However, we used an estimate of $300,000 in sales per employee, allowing for substantial productivity gains by the year 2010. If productivity does not rise rapidly the employment losses shown in Table 3 are understated.

According to these estimates, the personal computer industry will grow to an 588,000 employees in 2010 under the strong HDTV industry scenario, compared to just 147,000 employees under the weak HDTV scenario, a difference of just under 450,000 jobs. A similar difference in estimated employment gains can be expected in the semiconductor industry, where

331,000 jobs will be created in 2010 under the strong HDTV industry scenario, while just 83,000 jobs will exist under the weak HDTV base option.

Table 3 also allows us to compare the *total* estimated employment levels in all four industries that will be reached under each scenario in 2010. The differences are quite substantial. Under the Strong HDTV scenario, there will be nearly 1.1 million estimated jobs in these four industries, but only 274,000 jobs under the Weak HDTV scenario.

This means that *the US will forego more than three quarters of a million jobs in 2010 if it develops a weak HDTV industry compared to a strong one.*

Furthermore, these large job creation differences between the scenarios underestimate the total effect of not having a strong HDTV industry because the figures in Table 3 do not include any multiplier effects that would be likely to occur. Using a conservative multiplier, it would be reasonable to argue that at least another 1.5 million jobs will be foregone in 2010 by not developing a strong HDTV industry. Moreover, if flat-screen displays were used extensively in retailing, in education, or in automated automobile assembly, *direct* job creation would be greater than we have estimated for the four sectors, and multiplier effects would be proportionately larger. These estimates also fail to allow for new industries that might emerge as a result of the commercial development of digital television, digital communications and innovative flat-screen displays between now and the year 2010.

Table 1

ADJUSTED ESTIMATES OF US PRODUCTION
OF HDTV RECEIVERS, HDTV VCRs,
AND OTHER ELECTRONICS SECTORS AFFECTED BY
THE GROWTH OF HDTV
Three Growth Scenarios, 2010

(Billions of Dollars)

Sector	US Market	Strong HDTV	Medium HDTV	Weak HDTV
HDTV Receivers & HDTV VCRs	$ 11	$ 4.3	$ 2.0	$ 0.4
Automated Manufacturing Equipment	$ 39	$ 40.0	$ 24.4	$ 13.0
Personal Computers	$ 158	$176.4	$105.8	$ 44.1
Semiconductors	$ 101	$ 99.4	$ 59.7	$ 24.8

Source: These figures include adjustments that assume that for the Strong Scenario, 50 percent of the US manufacturers share is produced in the US and an additional 30 percent comes from foreign owned production in the US. For the Medium Scenario, the figures are 40 percent and 20 percent, and for the Weak Scenario, the figures are 30 percent and 10 percent. These adjustments are used to alter the estimates for world share of production by US firms in David Russell, "High Definition Television (HDTV): Economic Analysis of Impact," Report of the American Electronics Association ATV Task Force Economic Impact Team, November 1988.

Table 2

ESTIMATED TRADE DEFICITS IN 2010
FROM THE US PRODUCTION OF
HDTV RECEIVERS, HDTV VCRs AND ELECTRONICS PRODUCTS
THAT ARE AFFECTED BY THE GROWTH OF HDTV
Three Growth Scenarios

(Billions of Dollars)

Sector	Strong HDTV	Medium HDTV	Weak HDTV
HDTV Receivers & HDTV VCRs	- 7	- 9	-11
Automated Manufacturing Equipment	+ 1	-15	-26
Personal Computers	+18	-52	-114
Semiconductors	- 2	-41	-76
Total	+10	-117	-227

Source: These figures assume that for the Strong Scenario, 50 percent of the US manufacturers share is produced in the US and an additional 30 percent comes from foreign owned production in the US. For the Medium Scenario, the figures are 40 percent and 20 percent, and for the Weak Scenario, the figures are 30 percent and 10 percent. These adjustments are used to alter the estimates for world share in David Russell, "High Definition Television (HDTV): Economic Analysis of Impact," Report of the American Electronics Association ATV Task Force Economic Impact Team, November 1988.

Table 3
ESTIMATED EMPLOYMENT IN THE PRODUCTION OF
HDTV RECEIVERS, HDTV VCRs AND ELECTRONICS PRODUCTS
THAT ARE AFFECTED BY THE GROWTH OF HDTV
Three Growth Scenarios, 2010

(Thousands of Jobs)

Sector	Strong HDTV	Medium HDTV	Weak HDTV
HDTV Receivers & HDTV VCRs	148	7	1
Automated Manufacturing Equipment	133	81	43
Personal Computers	588	353	147
Semiconductors	331	199	83
Total employment	1066	640	274

Source: These figures assume that for the Strong Scenario, 50 percent of the US manufacturers share is produced in the US and an additional 30 percent comes from foreign owned production in the US. For the Medium Scenario, the figures are 40 percent and 20 percent, and for the Weak Scenario, the figures are 30 percent and 10 percent. These adjustments are used to alter the estimates for world share in David Russell, "High Definition Television (HDTV): Economic Analysis of Impact," Report of the American Electronics Association ATV Task Force Economic Impact Team, November 1988.

Note: these estimates are based on an assumption of $300,000 sales per employee in contrast to $150,000 for the key parts of the electronics industry in 1987.

CONCLUSION

The US stands at a critical juncture that will shape the growth of its electronics industry well into the next century. Since the new industries of high definition television and flat display screens are likely to have an enormous impact on our electronics industry, the fact that we have lost much of the consumer electronics base may lead some to minimize the impact of the new "digital revolution." But this revolution offers the potential for a dramatic revival of industries that could form the base for the creation of at least two million jobs and for a gain in our trade account of over $225 billion by the year 2010.

Given the strong government role played in promoting the development and commercial success of these industries in Europe and Japan, it is no longer logical for our policies to avoid supporting those industries that are critical to the future growth and development of our industrial base. If we continue to lose the skilled jobs and the innovative spirit of entrepreneurship that has supported the vitality of the US electronics industry since its inception, our economy will be subject to pressures that will cause substantial dislocation of industries and workers as we settle for a position as a "branch plant" economy. But with a revitalized electronics sector, our companies will have the opportunity to regain a leadership position in what have been called the "crown jewel" industries of the future.

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APPENDIX Table

WORLD MARKET SALES IN 2010 OF US FIRMS
UNADJUSTED ESTIMATES OF HDTV RECEIVERS AND HDTV VCRs
TOGETHER WITH SALES OF OTHER ELECTRONICS SECTORS AFFECTED BY
THE GROWTH OF HDTV
Three Growth Scenarios, 2010

(In Billions of Dollars)

Sector	US Market	Strong HDTV	Medium HDTV	Weak HDTV
HDTV Receivers & HDTV VCRs	$ 11	$ 5.4	$ 3.3	$ 1.1
Automated Manufacturing Equipment	$ 58	$ 48.7	$ 40.6	$ 32.5
Personal Computers	$ 210	$220.5	$176.4	$110.3
Semiconductors	$ 151	$124.3	$ 99.4	$ 62.1

Source: Derived from results presented in David Russell, "High Definition Television (HDTV): Economic Analysis of Impact," Report of the American Electronics Association ATV Task Force Economic Impact Team, November 1988.

CREATING AN EFFECTIVE U.S. INITIATIVE IN HDTV AND HIGH RESOLUTION DISPLAY TECHNOLOGY

by Robert Cohen

Several improvements are needed in the legislation that has introduced in Congress for an HDTV initiative. These include:

1. Emphasizing high resolution display (HRD) technology as a key part of the initiative.

2. Adopting Japanese-style mechanisms to facilitate the development of the semiconductor technologies that will be critical to the commercial development of high resolution displays and HDTV.

3. Assuring that Europe and Japan do not discriminate against U.S. electronics firms and their HDTV/HRD products.

High Resolution Displays Are Key

High resolution displays need to be included as a key part of any new legislation. Since PCs are likely to be the first beneficiaries of the new high resolution display technologies, this emphasis is critical. I have spoken to computer systems consultants who say that their clients would be more than willing to pay the premium needed to take the PCs off the desktops. When coupled with additional capabilities, such as full-motion video, taking frames off a VCR tape and incorporating them into a text or presentation, and enhanced graphics, these users would gladly spend well over a thousand dollars for higher resolution displays. A vast number of workstations and monitors that would have enhanced capabilities. With new digital display technologies and intelligent systems to broaden their range of applications, educational institutions, bankers and firms with more complex functions to control, such as auto, steel and petroleum refining plants, would find HRDs and HDTVs far more beneficial to their operations.

The high resolution displays (HRDs) used by industry and government could promote the development of new components. New video memory chips, graphics software and control devices need to be created for PCs and workstations. They would reestablish the infrastructure and skills needed to revitalize the U.S. semiconductor industry and

the semiconductor equipment manufacturing sector.

Mechanisms to Facilitate the Commercialization of HDTV and HRDs

New legislation should develop mechanisms to facilitate the development of high resolution display and HDTV technologies. Some of these might copy the Japanese-style mechanisms that have proven so successful in their programs for computers and semiconductors. One mechanism could be a high resolution display/HDTV Leasing Authority, with guarantees from the Congress and the ability to offer inexpensive loans to purchasers of HRDs/HDTVs. This Authority would make it easier for businesses to adopt these technologies. As a consequence, it would stimulate demand and provide for firms with the support to move to new generations of displays and HDTVs as they are developed. This mechanism might provide a real stimulus to demand. A Technology Development Association for HDTV and HRDs would enable both small and large firms to work on the manufacturing processing skills needed to get high yields from the equipment to produce screeens and the new semiconductors that they will use.

Volume will be key. Without the ability to produce memory chips for HDTV and HRDs in quantity and bring prices for key semiconductors down to the level where the final cost of HDTVs and HRDs is affordable to a broader part of the consuming public, any initiative will founder. This is what is so crucial about Japan's HDTV efforts. They will not only use consortia to develop the technology, but also create demand through the expansion of satellite transmissions, the use of HDTV screens in many industrial and business applications and the enhancement of transmission capabilities in their communications networks. They have an overarching view of how these technologies will affect their economy over the next twenty years. We lack such a concerted drive and also underestimate the challenge that Japanese success in HDTV and HRDs could pose to our economic vitality.

The Japanese Challenge

We should not have any illusion about the fact that the Japanese see HDTV and HRDs as a way to erode U.S. dominance in computers and software. Their approach repeats the succcessful strategy that Japan Inc. implemented in its VLSI Project. There, government and corporate sources helped "shape" the pattern of demand for emerging products and guaranteed a market while the new chips were still in their infancy. The new HDTV and HRD technologies might prove to be a "Trojan Horse" that will open the U.S. markets to an attractive, but "corrosive' technology that could leave our firms with few of the skills and innovative powers needed to compete in the next century.

At present, Japanese and South Korean firms are investing $6 billion a year in new semiconductor fabrication facilities. Our

nation's investment is not even close to this total. Thus, the control over volume production that is needed to produce less expensive chips for HDTV and HDRs has been developed in Japan and South Korea. Unless there is drastic action, U.S. firms may find that they are unable to achieve the price levels on semiconductors that are needed to remain competitive, in spite of the proposed government assistance. This would mean the demise of all but some "captive" production.

The Need for a Vigilant Trade Policy Linked to HDTV and HRD Development

Any proposed legislation should assure that Europe and Japan do not discriminate against U.S. electronics firms and their products. The European Community recently adopted regulations that require semiconductors sold in Europe after 1992 to have their critical diffusion stage performed in Europe. This has led to a flow of investments by U.S. firms that are fearful that they will be locked out of "fortress Europe." But such protectionist policies are not only wrong, they also reduce the funds available to our electronics firms to develop new products if they must invest in expensive production sites in Europe. The same thing is taking place in Japan, where few Japanese firms have fulfilled their pledges to purchase U.S. chips. Will we be left with the only open marketplace, but bear the costs of responding to protectionist policies elsewhere? This would have little economic logic.

The Policy Solution

What is the answer to this dilemma? The most relevant response is to see the present technological opportunity for what it is -- a period of dramatic change that will cast the die for world competition for the rest of the century. Any nation that wants to succeed in the HRD/HDTV markets must develop not only technological prowess, but also economic power in the marketplace. Its producers will need to be flexible enough to respond to new consumer demands.

This will require assistance from new policies that refocus the proposed HDTV initiative in the following manner:

1. Focus new legislation on high resolution displays and HDTV.

2. Emphasize cooperation in the development of new manufacturing process technologies, leaving open the possibility for joint ventures in this limited area with foreign firms that will bring knowledge to our firms.

3. Devise ways to assure demand for digital displays in their infancy through an association of firms, such as the ones that

are used by the Japanese, and ties to important parts of government and industry. There is no reason why NASA, DOD, and the Department of Education cannot create programs to develop a suitable level of demand for new high resolution displays, or why the Federal and State governments could not be a proving ground for these technologies.

4. Create additional mechanisms that facilitate commercial purchases of HDTVs and HRDs, allowing firms to take advantage of the latest capabilities that are incorporated into these displays. This could be accomplished through a leasing authority similar to the ones that have been used successfully by the Japanese.

5. Establish a strong policy in response to barriers that are limiting market access for U.S. electronics in Europe, Japan,

Mr. MARKEY. Thank you, Mr. Cohen. I will turn to the subcommittee for questions of the panel. What I'd like to begin by doing is just to lay out here one of the major debates that seems to rage amongst observers of this technology, and that is the contrasting statements that were presented by Mr. Flamm and by Mr. Cohen and Mr. Choate, among others, with regard to the significance of this technology.

Mr. Flamm says that HDTV is one of many technologies, but well down on the list of technologies, to quote you back to yourself, Mr. Flamm, that the United States should be looking at. Can you give us that list of technologies that seems to run a little bit contrary to what Mr. Cohen, amongst others, has stated the essential technology in their minds?

Mr. FLAMM. I don't have a list of technologies, I'm afraid. Let me just—I would—my response is two points. Number one, if I can think of projects which I think are—let me—point zero. I have no objection to some Federal role in supporting the development of digital imaging technology and I think that is a potentially significant project. It ought to be examined and compared on its merits to other possible projects——

Mr. MARKEY. If it's well down on the list, we don't want to adjust some of the other major——

Mr. FLAMM. Well, let me give you an example of a project that I think is of greater or equal importance, which certainly is in the purview of this committee, and that is getting on with the job of laying down a high capacity, high band width, fiber optic network in this country, linking homes with business and many other—with all users and sources of information in this country. I think that is the central issue facing our telecommunications network, and I think that's certainly an area in which the Government ought to be playing a significant leadership role.

We have a regulated or a divested telecommunications system with the responsibility for getting on with that job somewhat diffused today, but certainly I think that's—and that is complimentary to various statements that have been made about HDTV. Certainly the HDTV system of the future, no matter what it looks like, whether it's analog, whether it's digital, whether it's NTSC. You can see there's also been a considerable amount of dispute over these issues.

It's basically going to be in the business of displaying information and certainly a data highway which brings in all kinds of information, be it your television show, be it consumer information, et cetera, is a crucial part of that world view. So I would say——

Mr. MARKEY. Is there another technology as well?

Mr. FLAMM. OK. Well, let me interject for a moment.

Mr. MARKEY. The only point I would interject here is that our subcommittee, as you know, has jurisdiction over the modified judgment and over other areas and it is of enormous importance to this subcommittee that a broad band integrated services digital network be put in place in this country. We see HDTV as a central technology in its final application of bringing all of these services together, and we understand how a commercial, educational, business, personal use of the high definition television set, if that's what it's called at that point in time, will be directly related to the

fiber optic networking. Could you add some other item to the list so we can understand?

Mr. FLAMM. Sure. By the way, HDTV is a peripheral to that network, basically.

Mr. MARKEY. Peripheral, right, yes.

Mr. FLAMM. This is physically peripheral to the kind of network we're talking about. In any event——

Mr. MARKEY. Let me go—Mr. Cohen, is that a description you would——

Mr. COHEN. No, I don't think so. I'd like to give you, and Clyde Prestowitz started off with this story from MITI, let me give you another one that will clarify the way this is driven commercially. I spoke to someone recently who did work at MITI for the Vice Minister, who recently retired, and I asked him how does MITI argue with their government for an HDTV initiative? Why is there so much money going into this? He said we see HDTV as part of our infrastructure. This is like building highways, it's like building communications systems, it's like developing other things that are absolute national necessities.

Mr. MARKEY. I guess what Mr. Flamm would say is that fiber optics is the highway and that——

Mr. COHEN. The problem is what's going to drive—there's been a lot of difficulty. This highway has been proposed probably for the last 5 to 10 years. The difficulty that commercial users have had is there's nothing to pay for the development of this highway. So what are the uses going to be? If you had high resolution display systems in many of the factories that would take controls from those factory floors to off-site places, a lot of American firms would begin to pay for having that capacity in the ground.

If we had high resolution display systems and HDTV in the house, then you'd be able to get all sorts of different things. You'd be able to do home banking easier. You'd be able to do all sorts of things. Your kids could have their homework on line. In their schools, they could dial up, they could do it over HDTV. You'd have a myriad of applications that would then pay for the highway.

You can't just put the highway in the ground unless there are applications that will drive its commercial use. Therefore, I think that HDTV is not a peripheral. It's the drive——

Mr. RITTER. Would the gentleman yield for just a second on this line? I think Mr. Cohen makes a great point that the interstate highway system did not proceed the evolution, the initial evolution of the automobile. In the same way, I think the analogy is the HDTV and the fiber network, they are linked into the use of the highway.

Mr. MARKEY. I think you've helped to focus us a little more. Let me go to Mr. Choate. Can you help to focus us a little?

Mr. CHOATE. I would have a couple of thoughts in response to your question. I think we've got to start off by saying that we're not an impoverished Nation. So it's not often that having to just choose one simple and single thing. It's very clear from the comments here and other comments that we have many things that we must do in technology and one of the first things that we must do is reshape many of our approaches and reshape many of our relationships, both between and among industry and Government.

It seems to me that there are two real advantages here with HDTV. I think most of the people here, regardless of where they individually would put priorities, would say, of and in itself, it has an intrinsic national value to engage in that. It also has another advantage, I think, that is not quite as obvious, but it's very important. It is a great device to teach and lead with the American people as we go through this process of reshaping our technology policies. Most people in the country recognize what happened in America when we made the shift from black and white television to color television, and they can see that we're going to go through a similar transition. They can see that this is going to have many spinoff applications. So I think it's an ideal project to lead and teach and reshape national policy.

Mr. MARKEY. Thank you, Mr. Choate. Mr. Branfman.

Mr. BRANFMAN. Also, Bob Cohen is not the only one to disagree with Mr. Flamm. So do the Japanese and the Europeans. I mean, Bob just gave us those—there was the original $700 million that the Japanese we're told have invested and that now we just heard they've committed another $700 million, now up to $1.4 billion. If you start looking at the $3 billion I mentioned they just put in the last 6 months of 1988 of which, as I said, 67.5 percent are going either for HDTV 32 bit computers or intelligent workstations. All of these are going to be driven by high definition resolutions.

It's quite obvious that it's a major investment. The money generated from that will go to these other things. Now, what this really illustrates through, this discussion, is obviously we've got to have all—I mean, obviously this Nation has to have everything. We have to have HDTV, we have to have a fiber optic highway, and we have to get back into the office equipment business and all of the component business. I mean this has to be our national goal, and we can't be choosing on that level. This one's more important than that one.

Now, how much resource do you want to put at a given time is precisely why we need an Office of Strategic Analysis and we can't figures this out today, but I think it's obvious that we've got to develop the capacity to make these decisions after having committed to all of these major markets.

Mr. MARKEY. We'll let you have the final minute of my time.

Mr. FLAMM. Thank you. I can see my trepidations in bringing my doubts to this panel were well founded. I'm not suggesting that if American companies form a research consortia and go to the Government and say, look, we'll put up 50 or 60 percent of the funds for this, we think this is an important pre-commercial technology, would you be willing to match it, I think the answer to that ought to be, in general, given certain reservations about the nature of that, yes.

So I'm not disputing the fact that we ought to be supporting the development of advanced technologies. What I'm saying is that HDTV is not the bigger issue here. The bigger issue is should we have some structure in place so that when American companies are willing to put their money where their mouth is and come up and say we want to develop this technology, we think it's significant, is there some office, some point, some program where they can come to and get a response from the Government and that is

the most important issue. HDTV is a special case of that problem and that is my point.

Mr. MARKEY. I think that, if I could, Mr. Flamm, I think that that point is agreed to by the administration, and Secretary Mosbacher yesterday. I think he stated quite clearly that is his objective as well. I think to the extent to which it is possible for us to elevate this issue and to try to build a consensus at least around the idea that we're going to try to reach a consensus, that is, in and of itself, progress and I think reinforces the point which you have made.

We do have to have a structure in place that people can look to with some confidence as one that is on a continuing basis going to be reinforcing the interest to which private sector investors, entrepreneurs, and our creative people are going to be inputting into this area. So I think that we're not necessarily all too far off, although at the initial stage, it might seem that way. I think we can harmonize some of these various points.

I note my time has expired and I'll recognize the gentleman from Pennsylvania, Mr. Ritter.

Mr. RITTER. Thanks, Mr. Chairman. I want to just pick up where the chairman left off. It seems to me there really isn't disagreement. What you're saying is there's a larger picture out there that needs addressing. Is that correct? That needs addressing and I think everybody else understands that full well, the people up here at this table, and I think the people down there at that table, and I think a growing body of American opinion in between.

It's not as if the larger picture is being ignored. I think what we're faced with is a decision point amidst a whole host of other priorities that political system presents us with. We feel that this also could be a lead in to the rest of the picture. What are your thoughts on that? In other words, HDTV is not only important for its own sake, but it is conceivably a symbol for what else we need to do. Do you find a problem with that?

Mr. FLAMM. It's not so much a problem. I think that the direction—the objection I have, and it's not really an objection, a reservation, is that if we attack every technology issue on a piecemeal basis, this technology is the greatest thing since sliced cheese, let's go with it, and other technologies. As Mr. Branfman mentioned, you're going to be getting a stream of proposals and industries coming before the Congress in the next 10–20 years in area after area, proposing that the United States do something about its capacity in a particularly significant high technology area.

Now, do we want to have a structure in place that's basically going to say every case is treated as a special interest coming to Congress for treatment? Or do we want to put a broad general policy in place? Basically, America's high technology industries of today are based on an investment that was made during and after World War II, largely by the military services. We relied on defense investment in R&D for something like 20–30 years, more than that, four decades really.

And today we're finding ourselves in a situation where the traditional formulas for investment R&D are just not as effective. They're not effective because the defense technologies are more mature and there's less spinoff. They're not as effective as before

because we have international competitors who are nipping at our heels and willing to take those technologies and run with them if we don't commercialize them.

Mr. RITTER. Let me interject here. I agree with you, but we're faced with a cross-cutting technology that, as we have heard, is drawing in hundreds of millions of dollars in new investment, that impacts our capabilities in computers and telecommunications and industrial process control, advanced automation. We're faced with a decision right now, in the next several months, whether or not we're going to die on the vine or whether we're going to do something. Hopefully, that decision process can seed the growth of the new oak that will be America's high technology competitiveness perspective. That I guess was my point.

I'd like to, if I could, go to Mr. Hart. Mr. Hart, you mentioned that we ought to be careful about tinkering with the antitrust law because it could—I'm just paraphrasing—undermine our process. Could you tell me where all the competitors are in this particular area that could somehow be undermined by collaboration? I mean, it seems to me that we don't have too much going on at the moment.

Mr. HART. Yes. I mean, the HDTV case is an extreme one in the sense that in consumer systems only 12 to 13 percent of the U.S. market, not to speak of the world market in which a much smaller sum is controlled by a U.S. firm or U.S. firms, there's only one. So clearly if you are talking about production consortia for just Zenith, to name that firm, then you probably wouldn't have a problem of restricting competition in the sense that the antitrust law was supposed to prevent.

But what I'm concerned about is some kind of blanket antitrust exemption for an entire industry, regardless of how many people participate——

Mr. RITTER. You do not agree with the approach that Attorney General Thornburgh and recent past Secretary Faraday have submitted for the generic problem of getting back some of our high technology——

Mr. HART. Well, I actually agree with some of the things you've put in your own draft legislation, which had to do with changing the way you calculate competitiveness to take into account the amount of competition that exists in the international system as opposed to just looking at domestic market shares. I think that kind of change in the antitrust laws is long overdue, but I am a little bit leery of this idea of an exemption for a specific industry for production and/or commercialization of a specific product.

Mr. RITTER. Even though there's not much competition that is——

Mr. HART. Yes, because the question really is who is going to be participating in this consortium and we already know that it's open as to whether there will be foreign participants in the consortia. So if you don't specify ahead of time who is going to participate in the consortium, I mean, in your approach, there would be no foreign participants. I think that's an unrealistic approach, but——

Mr. RITTER. Well, in my approach we did not define domestic industry. We are growing in our understanding. I purposely left that

definition to be developed later with these hearings and what's going on.

Mr. HART. I think the acceptability of antitrust exemptions hinges upon exactly how you define what is a——

Mr. RITTER. Well, we've had some discussion here today as to what would constitute domestic. If it's all occurring here, it has a chance of being——

Mr. HART. I think the underlying goal in this case, because we are in such a weak position, is to combine a kind of short-run policy of building our capabilities by allowing partnerships basically with firms that have a major presence in the United States, both in technology and in production, but in the long term trying to build greater autonomy.

Mr. RITTER. But you would allow an antitrust exemption for partnerships.

Mr. HART. I think there should be R&D consortia involving foreign participants.

Mr. RITTER. You can have R&D consortia right now.

Mr. HART. But the problem that several industry associations have brought up in this matter is the question of private suits brought against, for single damages, brought against a consortia by a non-participant in the consortia.

Mr. RITTER. Well, the National Cooperative Research Act allows for this very thing right now. What we are talking about is pilot manufacturing, conceivably initial production.

Mr. HART. One marginal change in the antitrust laws which I think is probably not really too controversial is the question of going away from what is now a single damages provision for private suits to only allowing the Department of Justice to bring a suit against an R&D consortium.

Mr. MARKEY. The gentleman's time has expired. We can go a second round, if you'd like. The Chair recognizes the gentleman from Tennessee, Mr. Cooper.

Mr. COOPER. I thank the Chair. First, I'd like to spend a minute defending some of EIA's recommendations. I thought that Mr. Prestowitz was a little bit hasty and unfair criticizing them and I'm interested to know that Mr. Hart apparently had a hand in writing them. I was particularly worried about Mr. Prestowitz' technique of denigrating the source of the comments by criticizing the nationality of particular EIA members. To me, that's one of the hazards that we risk any time we engage in debates like this. It's the easy way to cut down an opponent by making fun of the country that they come from.

I would hope that all witnesses and all members could always valuate ideas on the merits, regardless of source. The Japanese had made fun of Mr. Deeming because he was American. They might not have had the productivity revolution that they had engaged in. The EIA recommendations for those of you who haven't had a chance to look at all the proposals are hardly selfish or controversial. They include things like reduced U.S. dependence on a foreign capital by cutting the deficit and increasing the national savings rate; shifting Federal spending to educational and worker training programs with emphasis on commercial sciences and technology; stimulating investment by changing the tax laws; making the R&D

tax credit permanent; funding public and private consortia to develop generic technology; relax antitrust restrictions on cooperative R&D activities to allow joint production; and, press for greater access to foreign markets.

Those hardly seem to me like trojan horse ideas that we need to be leery of. It is true that, more than other comments that the committee received, these are not HDTV specific comments and that worries apparently some commentators. But to me, these are all ideas that would help us in HDTV and other areas.

The real point I wanted to bring up was this. It seems to me that most Americans have the sense that the free enterprise system used to be able to produce innovation on time and used to be able to exploit it in the commercial market and somehow we've lost that capacity today. It's easiest for me to think of adjusting or changing the system in this way first, removing barriers that have grown up to the free enterprise system that prevent it from achieving its full potential. That would be in the first category.

The second category would be affirmative Government actions that we could take to supplement that, like generally subsidies. That's what most people seem to be interested in. In the area of removing barriers, I think we've had several examples of those mentioned today. Mr. Choate mentioned, perhaps facetiously, the slowness of receiving cable TV on Capitol Hill. There are many others, though. Perhaps the antitrust laws have gotten to be too strict. I think there would be widespread agreement on removing some of those barriers.

But there are also barriers that Mr. Hart and Mr. Flamm have at least alluded to, Mr. Hart was more direct, vested interests that have a gigantic financial interest in preserving either the way we distribute electronic signals or information today, or in delivery of those signals, of actual software. To me, for this committee to engage in a full and fair debate of these issues, we need to examine some of those structural things that have grown up over time, things that we perhaps take for granted, that nonetheless effect the outcomes in a very severe way.

Mr. Hart's bold and perhaps naive proposal about banning NTSC signals within 10 years is too revolutionary probably even to joke about in a public hearing, but I think it illustrates an interesting theoretical point that that might perhaps be the fastest way we could possibly choose to accelerate the delivery of a new technology to the American people.

In the area of government affirmative action, giving money or making permanent an R&D tax credit, doing it indirectly. It seems to me that's where we always get the feeding frenzy on the Hill. Most everyone has their hand out and some are more dignified in asking than others. This industry seems to be particularly dignified. I congratulate them for that but still, we shouldn't overlook what we're doing. It seems to me unlikely that Congress is going to be able to make wise, sustained and sizeable investment in particular technologies and even if we were able to succeed in this area, we would probably be overlooking a lot of worthy other technologies that didn't happen to be TV-related and therefore easily identifiable to the American people.

It's no coincidence in my mind that TV has captured the attention of these TV cameras here and most of you in attendance of the room because it's a consumer-led technological change.

Mr. MARKEY. Can I note for the gentleman—NHK—there are no American networks in the room.

Mr. COOPER. And I thought I was speaking to a C-span audience.

Mr. MARKEY. Straight to Osaka.

Mr. COOPER. So, it seems to me that if we're going to seriously examine these issues, we're going to have to tackle a lot of the touchy and perhaps unpleasant underlying issues that will end up shaping the outcome of the debate.

I want to particularly congratulate Mr. Hart and Mr. Flamm for I think having delved into those a little bit more deeply than perhaps is popular or easy to do. I thank the Chair. I didn't really have a question. I had that long speech.

Mr. MARKEY. People who go to Harvard's questions tend to take the form of answers anyway.

The Chair recognizes the gentleman from California, Mr. Moorhead.

Mr. MOORHEAD. Thank you, Mr. Chairman. Mr. Branfman, in your testimony, you forcefully state that the old rules are not working. Old new answers are needed. You propose both an industry-led strategy and continued coordination by Congress and the Executive—cutting edge.

There's an old saying that a person should lead, follow or get out of the way. If according to you the industry is to lead, what is the role of Government? What do you think Government should do? What should a constructive role for the Government be after modifying statutes to permit expanded industry initiative?

Mr. BRANFMAN. Thank you for asking. I think that is the key question and it's a—as I said, I think we need new answers and it's not easy to give a definitive answer to that because this is a subtle process that we need to engage in. The key thing I'd like to stress here is when we talk about industry-led strategy, this is not some kind of a new theory.

In fact, it's already happening. That is to say, some portion of the electronic industries got together and formed something called MCC and said, well gee, we don't want your money right now Government. We just want a little help from the State of Texas in getting started. So, that's what they wanted in that case. In the case of Sematech, they wanted $100 million a year.

In the case of the National Center—now MCC by the way is coming to DARPA to ask for some money on the—for HDTV. So, what I think we want to aim for here is No.1, Government commits to helping—at least giving as much support to its industry as foreign companies are getting from their industry. That's the bottom line. I wish we were living in this free market world that Mr. Cooper just described but we're up against tremendous forces here and I think that's the principle.

Now, what kind of help are we talking about? There's all sorts of things that have been listed: low cost Government loans is an option for HDTV. You could have direct buys from either the Defense Department, the Education Department or the first products of a U.S. consortium. Another option could be a general R&D tax

credit or a targeted R&D tax credit for certain industries or other targeted tax incentive. You can have help on anti-dumping—has been discussed.

The antitrust issue is another option. You have a whole range of options. I personally agree that Government is not really in a position to take the lead in revitalizing every industry in America and making these decisions and that's why I'm pushing for this concept of an industry-led strategy but Government has to let industry know in advance that if they take the lead, they're going to get this kind of support from their Government.

One last point in this area that also perhaps responds to something Mr. Cooper said, we have submitted for the record a white paper by a bunch of economists including Nobel Laureate Solow that strongly supports all of these macroeconomic measures—reducing the deficit, improving our education system and so forth but I think we have to realize that if we're going to wait for this Government to reduce the deficit in order to bring down the cost of capital, we're not likely to have any industry left let alone all these other things.

Even at best, if we did it tomorrow, it would take a long time for this to filter down. We're looking at a cost of capital as Bob suggested 4 or 5 times and on occasion 6 or 7 times greater for an American company than their competitors.

I think the basic principle is that Government has to create an environment that equalizes the cost of capital. Otherwise, I don't know how we can do it. I think that's the overall issue. How you do it can be discussed, as I've said.

Mr. MOORHEAD. You talked about HDTV being a technology driver. Do you think the Defense applications will drive the commercial applications or will it be vice versa?

Mr. BRANFMAN. It's more likely to be the commercial driving the defense. What we found over the years and you know in the 1950's—Mr. Flamm has written a very good paper. I recommend to everyone about the role of Government in the 1950's in creating silicon valley. We often forget that. We had a very good example there of an industry-led strategy where we combined entrepreneurialism and strong Government support to create the semi-conductor industry.

At that point, we didn't have strong international competitors in semiconductors. The Defense Department could do its magic. Maybe it took a little slower than one might have wanted but with time, the thing worked.

Now, what we're facing in the 1990's of course is we've got a Defense Department that has—largely because of a lot of us reformers—very cumbersome rules and regulations. Sometimes it can take years between when a contract is first discussed and when it's finally written.

During that time, our competitors, the Japanese, dealing in much more fast-moving commercial markets have already gone through 2 or 3 generations of development, and I think you'll find very interesting people like Dr. Noyce, the head of Sematech, the father of Silicon Valley telling you that the Defense Department today is more of a hindrance than a help in developing new technologies.

Mr. MOORHEAD. I saw you shaking your head there. Do you have a comment to make about this?

Mr. HART. Basically I agree with Mr. Branfman that the commercial technology is much more likely to produce the required result in the sense that it's only with that need to build high volume low price products, especially in the realm of consumer electronics that you'll get the kinds of innovations that you need to actually get a re-entry of the United States into consumer electronics markets and by the same token, there are many spin-offs from re-entering consumer electronics markets for general manufacturing of electronics which will have very positive benefits for our defense electronics in the sense that defense contractors if they apply those techniques which will have to be learned for consumer products will be able to produce defense electronics in a much more cost efficient way. In fact, they are now beginning to realize that and are interested, to some degree, in the HDTV issue as a way of using some of their sophisticated, sometimes defense-sponsored technology to get into consumer markets.

Mr. COHEN. I feel you're overlooking something here. That's what's going on overseas. A lot of the propositions that have been raised by the commentators just recently really overlook what the Europeans are doing to force the direction of investment.

Europe recently passed community-wide laws that will require that any semiconductors sold in Europe have to have 50 percent of their content in Europe. The key part of semiconductor production will need to be done in Europe, so a U.S. company like Intel, thinking about where to invest, will need to put two separate plants in place in Europe by 1992 if it wants to continue to sell in the European market.

There's no framework in the United States that says OK, here's an American strategy for revitalizing the microelectronics industry while we're facing a Europe of 1992 that says, we have a strategy. If you want to get in here, you have to put money on the table. You have to invest in new plants and equipment, and you have to be tied into programs that promote a European HDTV industry, a European high resolution display industry and the development of a European communications network.

In Japan, we have the same thing. American companies that want to be in Japan have to have a cooperative arrangement with a Japanese company. They have to be part of the Japanese consortia. There will also be pressures on American companies if they want to be part of those consortia to keep doing things in Japan. As long as there are no incentives in the United States to revitalize this industry, that's what we're up against and at the same time, there are a lot of technological strengths here.

The most productive companies in creating high resolution display manufacturing equipment are in the United States. That's one of the reasons Japan is putting $700 million into the new media initiative. They're going to take our equipment, figure out how it works, figure out why it's most productive and then build it themselves.

They won't have to buy American anymore. They'll wipe out that part of the industry. So, unless there's some action and there's a critical window for that sort of action, the other competitors

worldwide in both Europe and Japan are going to put together their groups of private companies, put together their incentives and create even more difficulty which as I've shown in the study could create economic impacts here that would be quite disruptive.

I think all you have to do is look at the programs that have been put in place over the last 10 to 15 years. In Europe, the community has put in place a Race program for telecommunications equipment and systems, a Bright program for industrial technology, an Esprit program for microelectronics, a Eureka program for information technologies. The Eureka program is largely driven by private companies.

I think that's the sort of framework that we need and I think the legislation that's been proposed so far really needs to be expanded to look at this in a broad sense, to look not only at HDTV but also at high resolution display technology, to adopt some of the mechanisms that are used both in Europe and by the Japanese to facilitate the development of not only HDTV but also the semiconductor technologies that are critical to commercializing this field.

Also, to recognize the sort of limits that are being put on our companies by the restrictions for local content in both Europe and Japan. If we don't have some sort of reciprocity, we will basically have to pay the price of our companies needing to make decisions. Do they invest in the United States or do they keep their European markets and Japanese markets.

Mr. MOORHEAD. One of the threads running through the testimony here is that an exemption from the antitrust laws should be provided to foster HDTV joint ventures. Is it appropriate to punch a hole in the antitrust laws just for HDTV or just for electronics and high-tech industries or should we have a comprehensive re-examination of the Sherman and Clayton Acts to permit greater industry cooperation and coordination across the board? Mr. Hart's an expert in this area. Do you want to kick off on that?

Mr. MARKEY. I'm afraid you're going to have to answer in 1 minute, Mr. Hart.

Mr. HART. No, I think you've posed that question which is a general question for this committee—do you do industry-specific things or do you do things at the whole economy level. In the case of antitrust there are very good reasons why you don't want to establish precedents at the industry-specific level which you may not want to follow at the economy-wide level. There's a tendency for industry-specific measures to get generalized because every industry asks for the same thing.

Now, in the case of antitrust law, I think there do need to be revisions. One thing you need to do is to change the continuing restrictions against R&D consortia to relax some of those so that there will be more R&D consortia formed.

There seems to be a fairly general agreement that the continuing existing restrictions against R&D consortia is inhibiting the formation of those consortia and I think we need more of those consortia. The argument that's been used is that it's better to have consortia than to have mergers because mergers are almost directly anticompetitive, especially if you have weak enforcement of the rest of the antitrust regime and therefore, better to have consortia which are temporary and usually functionally specific.

Then the question is, should antitrust exemptions start to extend down the chain into production and commercialization and there, I think really you can realize a lot of the benefits of your R&D consortia with real joint ventures.

We have joint venture laws and we have limited partnership laws as well. It seems to me that a lot of the problems really exist in making the licensing arrangements between the R&D consortia and the production and commercialization ventures that spring from them, but I think we've already moved a bit too far, it seems to me, in loosening the atmosphere for mergers and acquisitions—LBO's and that sort of thing. It's just my personal opinion that that's not the way to go with our national policy.

Mr. MOORHEAD. I'd like to see if that's the universal opinion of the panel or whether there's contra-opinion or a different opinion.

Mr. MARKEY. One thing I'm sure. It's not the universal opinion of the panel.

That I can tell you. I will allow the gentleman to proceed.

Mr. MOORHEAD. Somebody would like to respond, perhaps?

Mr. BRANFMAN. Again, this is the old rules do not apply. To start out with one basic point, we wrote antitrust laws back in the 1920's when we were talking about a few American companies dominating a market. Today we're talking about revising antitrust laws because they're no American companies in these markets or very few.

There are only Japanese companies and in fact, it seems to turn everything on its head but conceptually what you're saying is that if you were to revise these antitrust laws even for joint manufacturing, it would actually get more companies in and presumably increase competition to that extent, especially if we feel that we're suffering from these Japanese cartels.

Now, whether—I tend to think of this point as a Nation, given all of these ideological disputes we tend to get into, that we're better off when we talk about revising the antitrust laws for joint manufacturing and production to have two basic principles. No. 1, if six U.S. companies that have formed a U.S. consortia 2 years from now that say hey, gang, it's going to cost us $4 or $5 billion to build an HDTV manufacturing plant and we can't afford it and we don't think that doing it as a joint venture is not going to work for the following reasons, then I think we should take very seriously revising these laws.

Second, I think at this point, we should target it on these strategic industries because we'll probably have enough debates about antitrust laws even within that context but I think at that point, there's enough of a consensus in this country about what strategic industries are that we might be able to come to a consensus on how to revise the antitrust laws.

Mr. FLAMM. My one comment on the antitrust issue is this. There's broad agreement, I think on the issue of antitrust liberalization for R&D consortia. The place where the lines sometimes get drawn is around production and commercialization. The argument that I've usually seen made for liberalization of antitrust as applied to production is that if you have a R&D consortia, how do you ensure that that technology is transferred downstream to produc-

tion unless the same folks who are involved in R&D are also involved in manufacturing?

That's usually the way I've heard the argument presented although I may have missed something along the line. In any case, if that isn't the argument, then I think one of the things that ought to be done is to state that argument clearly. Now, let me tell you why I think that argument is lacking.

If you look for example at Japan where R&D consortia have been elevated to a fine art, if you will, you don't find downstream joint production as a typical mode of technology transfer out of R&D consortia. In fact, what happens—technology resides in people's heads. That is the ultimate store of technology and the way technology is transferred downstream is because engineers and scientists have participated in the joint R&D consortia then go back to their parent company and take that knowledge, that know-how with them and use it to commercialize commercial products.

Now, why is it required that in the United States, we—right now, companies do joint ventures all of the time. Is there any crying need for liberalization of antitrust as applied to production of joint ventures? That's the question I'm posing. It seems to me that the transfer technology argument is clearly not so in Japan.

What prevents the same logic from working here and as far as the barriers to joint ventures in production, I see them everyday going on in the U.S. industry. Why is it more of an issue here than in other areas? That's the question I pose.

Mr. COHEN. Well, I agree that there are some problems but given the interest in this field and in really moving this field ahead very rapidly. I mean we've had 87 firms apply for funds from DARPA. You've had more than 30 firms sign up for the consortia that would be sponsored by the American Electronics Association.

I think that one of the things these firms are questioning is where do they go after Sematech? Sematech is essentially proving manufacturing technologies. Second, there's a recognition that we are behind, particularly in the area of manufacturing processing.

So, I think what is very logical is you want to push this field ahead, one of the steps that Congress could take is to permit companies both large and small to come together in a manufacturing technology consortium that would be closer to the consumer market than Sematech and to get a quid pro quo. I mean in the Japanese situation, the Japanese government makes loans. If the consortium is successful, the companies pay back the loans. If they fail, they don't.

In this case, the Government could get a quid pro quo. Maybe the Government should take some sort of shareholding in that corporation. If it spins off profitable operations or leads to fairly profitable operations that the Government should get some sort of payback or maybe you want to look at some of the economic benefits of promoting that and what it could be linked to.

Again, I think what you come back to is the framework that needs to be put in place to revitalize this specific industry because it sweeps through so many other applications in the economy.

Mr. MOORHEAD. Thank you, Mr. Chairman, for being generous.

Mr. MARKEY. I thank the gentleman very much. As a member of the Judiciary Committee, I know you'll find this helpful. It'll trans-

fer technological information over to that committee's deliberation. I'd like to ask each of you to help us prioritize those things that we ought to be doing.

There seems to be a consensus amongst the things that we ought to be doing in the action memos which were sent back to this committee with regard to macroeconomics, that we should be focusing on as a Nation. What I'd like to do here is just to list for you the areas where there seems to be some consensus and then maybe you can help us to prioritize within that area what we should be focusing on.

Here are the areas; formation of a public-private consortium for R&D of HDTV products, establishment of R&D tax credits, government matching grants and relaxation of the antitrust laws to permit joint manufacturing. Now again, we understand that perhaps it's important for us to work in each area. Maybe you can give us a sense of the importance of each one of these things in sending the right signal to the private sector that we're serious now as a government. Mr. Branfman.

Mr. BRANFMAN. Yes. I feel very strongly about this that what we need to focus on are the its. What are the its in this case? There has to be a something and possibly two somethings if our mindset is to create an HDTV industry and by that I mean an HDTV industry that's producing both receivers and related products—VCR's, computer monitors and the like—with U.S. components. That's a pretty tall order.

Now, I think Mr. Flamm is right on target on one of the somethings. I think there has to be some kind of a fund or an operation set up in government where industry knows it doesn't have to reinvent the wheel every time and come to on a more regular basis and have discussions and try to figure this out.

We at one point were calling it a "tech fund," and suggested there should be an industry board that should make the decisions rather than government officials but that's something to be discussed.

However, the other point is one I really want to stress, is I think there has to be some kind of a U.S. consortia and therefore, that with U.S.-owned companies composed of U.S.-owned companies. Now, I'm sorry Mr. Cooper isn't here because perhaps Mr. Prestowitz—where he put it is unfortunate but I think the principle is very important here.

This idea that's sometimes brooded about that as long as Sony America and the Japanese companies build the plants here and somehow defuse the technology although it's a little hard to specify how that's going to happen, everything's going to be OK. I think it is a very unfortunate idea because for many, many reasons—I'll go into the testimony—but the bottom line on that is not to overextend this is, they don't do it that way. They don't say, well gee, you know, we'll just sit back and let the Americans build an HDTV industry.

I mean they decided to invest an awful lot of money in getting that technology for themselves. I think we need a U.S. consortia to guarantee, to have the leverage. Just as one example, when we didn't do this in semiconductors, our computer companies—theoretically the Japanese told us well, you can just buy your chips

from us and of course, our computer companies feel so strongly that they were discriminated against that they're now entering into agreements to buy chips from American companies.

So, we need a U.S. HDTV consortium. Now, at that point and I think prioritizing matching grants to a consortium is the best Congress can do. At this point, other than what as I said before, setting up this committee that would meet with industry and just work to make this happen.

Now, at that point, let's also be clear. Once you have a U.S.-owned operation that's in charge of developing HDTV, it ought to be encouraged to contract with foreigners to be sure. First of all, they have more technology than we do. Second, we're not anti-foreigners. In fact, I go even further and say the eventual vision of this thing—once America's ante'd up and is back in the game, should be coproduction. I mean in the long run, it's pointless for the United States, Japan and Europe to be engaged in an economic arms race and so forth.

Mr. MARKEY. Can you help us—the point which the American Electronics Association makes which disagrees that the way to increase U.S. competitiveness is to encourage foreign investment in the United States. They stated to the subcommittee that owners tend to ensure that critical technologies do not find their way into competitive hands and further. The AEA asserts that foreign owners reserve the right to adjust their manufacturing and development plans if economic or political conditions change.

Finally, AEA asserts that owners control the profits which in turn drive the R&D, capital investment and state of the art advances. So, who is right? Is foreign investment in the United States good or bad for United States' competitiveness?

Mr. BRANFMAN. Well, again I certainly agree with the AEA position. This doesn't mean that we should shut out foreign investment. Our overall principle at Rebuild America is, it's time to stop complaining about foreigners. Even if they're doing things wrong, we're putting so much political energy into that we're forgetting that what we need to do is stand up on our own two legs as a country and match them subsidy for subsidy, action for action.

So, I think the principle is, let's target massive investment into creating the strategic industries of the 1990's, getting back in the game, let's regain control of our economy and at that point, we should be encouraging foreign investment.

Mr. MARKEY. Thank you. Dr. Hart, can you give us a bit of wisdom on this?

Mr. HART. That's a tall order. No, the problem is that we're in this weak position and we're also in a position in which we have allowed foreign firms and particularly European firms to purchase some of our strongest consumer systems producers and it's no secret, that's Thompson and Phillips—Thompson is what used to be RCA and GE and Phillips is what used to be Phillips, Sylvania and a couple of other firms.

Both of these firms have a large presence in the United States both in manufacturing and R&D. The question that's before you and for the Nation at large is, do you try to use these capabilities which are now owned and for the most part controlled by foreign firms and I think this has to be thought of as a shorter, medium

term expedient because I think in the long term, you do want to have more autonomous control over this industry. In the short term, you don't have a lot of choice, it seems to me and therefore, I think you have to——

Mr. MARKEY. In other words, you have this competing view of what is good for America. The Electronics Industry of America would say well, foreign-ownership is not so bad. They invest in the country and everything is in the long run going to be fine because they've got a piece of the rock and they're not going anywhere and they don't want to damage the country where they've got this major investment.

On the other hand, the Electronics Industry of America says come on, grow up. You know? These people long term have a stake in their own country's best interest and when push comes to shove, you don't have to be a Ph.D. in economics to realize where they're going to be making their hard decisions in terms of protecting assets.

So, you're saying basically to us, short term, you can't do anything about it.

Mr. HART. No, no. I'm not saying that. In the short term, you can do very specific things to encourage consortia, for example, and I think you should encourage consortia which have foreign participants if the foreign participants can bring to those consortia some of their technology, some of their manufacturing skills which builds U.S. competitiveness.

In fact, it's quite likely that foreign-owned firms will do that better than the U.S.-owned firm will. So, this is an irony of the situation. Other countries are used to doing this because they have been traditionally in weaker competitive positions to the United States. It's a combination of our own weakness and perhaps some poor policies of the past that has led us to this past but we have to make the best of it and it seems to me to have a kind of U.S.-only approach here which you end up with as a kind of hot-house flower that can't survive in the real climate of world competition.

Mr. MARKEY. So, you're saying after basically constructing this necessarily foreign partnership at some point down the line we could then make additional determinations.

Mr. HART. Yes. I think you have to supplement the short-medium term partnership strategy with a long-term, build-your-technology-and-manufacturing-base strategy.

Mr. MARKEY. Thank you. Mr. Cohen.

Mr. COHEN. I think this is a bit of a quandary here because on the one hand, you have very different views but on the other, you're not really recognizing the fact that limits have been placed on the way in which industry develops outside of the United States.

In other words, when the Europeans have set up the consortia, they say OK, if you want to be in a consortia, you have to do basic R&D in Europe. You have to do key production steps in Europe that then require transfers. We haven't done anything like that so I think if we set up the consortia, if we're going to have foreign membership, they have to be coupled with these sort of requirements.

On the other hand, the second part of the quandary is I think that the Japanese as Clyde said, not only see this as a way of the

United States getting back in. They recognize this as a completely new technology that we might completely change positions and if we are strong in HDTV——

Mr. MARKEY. Changing places, he would say.

Mr. COHEN. Right. We might be changing places with them. So, they want a part of the ballgame if it's going to be developed here. So, I think what we ought to do is basically public-private consortia, not necessarily limited to just large firms, but making it much more available to smaller companies that have been highly innovative in developing these technologies where we have a lead now. I mean we are very strong in manufacturing equipment for this sector. I think second, you want to tie that to a relaxation of antitrust laws with some sort of reciprocal agreements with the companies involved and with R&D provisions.

Second, I would see using R&D tax credits and Government grants for specific key technology developments with a joint civilian DARPA emphasis, that DARPA won't drive this on its own. You have to have a private sector initiative also.

Third, I think you have to assure that there are trade provisions, that we aren't trading places again because the Europeans decide that a lot of investment has to be put in there or R&D has to go there. We want to make sure that if they have a provision we have the same thing so that they can't gain unfair advantages and the same for the Japanese.

If they're going to play our ballgame, they're only going to take us seriously if we have the same sort of recognition of what's at stake that they do and I think we ought to recognize that there are vast spin-offs here. I've heard that there's going to be products coming out that uses the ability that U.S. companies have developed to put chips on glass that will be in optical character readers and some of the laser printers in the next few months.

This is like a spin-off from this industry that creates huge potential. If we can put chips on glass in effective ways, we do away with printed circuit boards that you've seen in the computers and things like that. It creates a whole new potential for miniaturization that could be driven by the United States.

Mr. MARKEY. Got you. My time is expired. I will recognize the gentleman from Pennsylvania for the last set of questions and we will note that at exactly 12 p.m., all time will have expired for this hearing.

All will have to come to a close, as I have a luncheon engagement. So I'll recognize the gentleman from Pennsylvania.

Mr. RITTER. Thank you, Mr. Chairman. I just would like to start off, given that Dr. Prestowitz had to leave, and Mr. Cooper is gone. I, frankly, in listening to his comments, did not detect a pejorative tone. I did not detect a tone of making fun of. I think I detected a tone of what I might call gross realism and if you read Trading Places, in so many portions of the book, the level of admiration of Clyde Prestowitz. What he is saying, however, is wake up America, stop sleepwalking.

The gentleman from Tennessee talked about free market. Does anybody at this table believe that the market for the things that we have been talking about all morning is free? Raise your hand if you do. I mean, it's as free as a gulag. There have been strategic

decisions made in one of the competitive nations. Clyde Prestowitz is not faulting the strategic decision process that has been made in that Nation. He may say it was against the international trading agreements, which it was, and which we have lock, stock, and barrel proof in Court cases.

What I heard Mr. Branfman saying, Mr. Cohen saying, and Pat Choate saying, is that, hey, this really shouldn't be ideological, yet I hear there's still this theoretical argument, this ideological argument that we're going to decide how many angels are dancing on the head of the pin while all the pins are being produced elsewhere.

Just a question. Some people have said that—some critics of the approach that I have taken, which, by the way, if you were there yesterday and from what I hear today, there is real general consensus on the elements that the chairman went through, consortia, R&D tax credit, some cost sharing leveraging, the Federal funds, Government purchases. I don't think there's much disagreement.

There are critics that say that America's technology in the area of digital is such that if we just left things as they are, we will not only catch up, but we're going to be ahead and the computer companies are going to move into HDTV and America's problems are over. Does anybody want to comment on that?

Mr. BRANFMAN. Yes. Let me put in a plug. Incidentally, the person saying that is George Gilder and he and Richard Elkus are going to be having a debate on March 22 here on Capitol Hill so people can——

Mr. MARKEY. Where is that?

Mr. BRANFMAN. It will be in S-207 between 12 p.m. and 2 p.m. and those folks who want to hear the full explication of this argument can hear it. The fundamental problem with that argument is that guess who invented digital? I mean, ever heard of a compact disk player, digital audio tapes? The assumption is somehow that, yeah, we have some advances in digital in certain areas than in others, and somehow they're not going to do anything where we're strong and that's the fundamental mistake.

If I could just respond to one other thing that comes to mind from what you're saying. One of the things Elkus always talks about that I think is the key concept is this idea that Japanese target interrelated end use markets, which is a fancy term for an HDTV that effects about 6 or 7 other markets and then they'll go after all the other things, computers, and so forth that do the same, and somehow our economists look at that and they can't see the end—as you say, they don't see the end result. They see all these other things in the middle somehow and to me it's quite bewildering.

Let me give you one concrete example I think sums this whole thing up for me that just came up last week. This Intel, poor little Intel, all they're trying to do in the world is sell semiconductor chips, right? So they're in Europe and a Japanese printer company, they didn't tell us who, has 55 percent Japanese chips, 15 percent European chips, and I guess 30 percent U.S. chips, Intel chips, in its printer that it's selling in Europe. We don't make printers anymore. The Japanese make the printers.

Now, the Europeans say guess what, gang? You've got to have at least 30. Now, what are the Japanese supposed to do? Well, we'll keep buying the U.S. 30 and we'll reduce ours from 55 to 20. Now, they say, look, we're going to keep our 55, goodbye Intel, we're going to put European chips in there. Now, that's an end use market, the printer. Now, I can't blame the Japanese for that. I'd do the same thing. You would, too.

Do we want to reduce the United States to the point where we're begging people to take our chips or do we want to be producing the printers so we have the leverage to decide what chips go in there. That's the fundamental issue.

Mr. MARKEY. Is that, in its own way, a summary of what we could look forward to in Europe 1992?

Mr. BRANFMAN. No question.

Mr. MARKEY. As the United States adopts kind of a free trade policy, meanwhile the European community and the Japanese are playing by a different set of rules.

Mr. BRANFMAN. Congressman, we're not only number two right now, we're number three, we're a third-rate HDTV power and this is going to be our future if we don't wake up here.

Mr. RITTER. Mr. Cohen.

Mr. COHEN. And I think if you want to add to that what the possible problems would be, that these are the drivers that the HDTV and the other commercial uses for the electronics are going to drive a whole range of other things, including the digital networks that Ken was talking about, so that they're playing hardball. They want to be the first in place with really advanced technology that they see promoting the resurgence of European industry, of Japanese industry in the latter part of this century and the early part of next century. Unless we begin to play that game in a hardball way, I think here Congress has an opening within the next couple of years to make some decision about dealing with this issue in a different way.

Mr. RITTER. Dr. Hart, do you want to briefly comment? Again, the question was is it going to happen by itself?

Mr. HART. I think there are two questions on the table. One is this question of should the United States match what our competitors do, particularly in Europe and Japan and I think, unfortunately, the answer is we have to, to create a credible leverage for reciprocity that if we don't match what they do, then we can't bargain with them about undoing it. In fact, it would be the world's benefit if we all undid all these things. What we end up with is what I call the technological equivalent of the arms race. Everybody spends extra money to get ahead of the other guy and they all end up more or less in the same place.

Mr. RITTER. If you have one player——

Mr. HART. It's just like an arms race.

Mr. RITTER. Isn't that what happened?

Mr. HART. Yes, right, absolutely. So you've got to at least threaten to do what the other guys does in order to get him to stop doing it. It would be better if you stopped doing it than if you matched him. But unfortunately, you have to——

Mr. RITTER. Nobody is giving up the motis operandi of their industrial economy, that is, Japan.

Mr. HART. No, but if you progressively match one another in this kind of stuff, you end up basically subsidizing your industry. In order to gain competitive strength, but those competitive strengths can be neutralized by what you're competitors spend. So the point is you get a situation where you end up in the same place after spending extra money. It's like an arms race. It's something that you don't want to get into on purpose.

What you want to do is deter the arms race. I'm sorry. If you don't——

Mr. RITTER. I understand exactly what you're saying.

Mr. HART. The second issue that's on the table is a question of digital TV and digital TV—it struck me, George Gilder is absolutely, 100 percent, maybe 300 percent wrong, because when he says wait for digital TV, we're going to be incredibly strong when—well, first of all we don't know when digital TV is going to come. The industry has been talking about digital TV for 20 years. It could be—in fact, the Japanese estimate we won't get digital TV for 24 more years.

In the meantime, they will have done so well in consumer electronics, in other words totally eliminating their competition, they will have taken advantage of their consumer electronics strength to improve their strength in other areas.

Mr. RITTER. I think we got the answer. We're running out of time. We're stopping at 12 p.m., so let me reclaim my time. Please close with this idea. If we had behaved in the arms race the way we are behaving in the global economic battle, Russia would rule the roost, the Soviet Union, excuse me, would be ruling the roost.

Thank you, Mr. Chairman. I yield back.

Mr. MARKEY. I thank the gentleman very much. I thank all of you, including Mr. Prestowitz and Mr. Choate for their participation. This subject matter does bring out the best of us and I wish that Mr. Cooper could have stayed to see how it heated up. He might want to have amended his earlier comments. I think if he could have stayed here a little longer, we could have even further I think enlighten the subcommittee on these issues.

We're going to progress in a very expeditious fashion on these issues. We have asked for you to participate in this hearing because of your renown in your fields. What we'd ask is that you stay very close to us because we're going to move very fast and we're going to try as best we can to crystallize these issues so that our subcommittee and the public can understand them.

As you're going along and watching various developments in each of these areas, don't think twice about picking up a phone and calling the subcommittee and give us your little slant on what you think you're seeing developing as the days go by. What I've asked as well is for you to respond to written questions that the full committee Chair and others will have on this subject and to please get those responses back to us as quickly as you can.

I'll recognize the gentleman from Pennsylvania.

Mr. RITTER. Thank you, Mr. Chairman, and thank you for an excellent hearing. I'd like to ask each of you and Mr. Prestowitz as well as Mr. Choate to supply for us your opinion on allowing the telephone companies into the RBOC's into information services and also to respond to the question of cable Tel/Co cross ownership,

what would be your opinion as to how that could impact on what we're discussing here today.

Thank you, Mr. Chairman.

Mr. MARKEY. I thank the gentleman. We're going to be working very closely with Secretary Mosbacher, with his Executive Department, the committee, with Craig Fields from DAPPA. We'd like to work with you, as well, to help to develop it. I might offer that same invitation to everyone who is here. There's no, I think, at this point, exclusive on insight into this area and I think from all these various perspectives, we might be able to develop a policy.

That's the full intention of this subcommittee, to see this year end with the United States having articulated a purpose that we want to see achieved over the next decade. To the extent it's the first rough cut that we're seeing here in these committee hearings and that what we do by the end of this year might not be able to foresee all of the additional modifications that will be necessary, we intend to begin the work.

We thank you very, very much.

[Whereupon, at 12:02 p.m., the hearing was adjourned.]

[The following correspondence was received for the record:]

U.S. House of Representatives
Committee on Energy and Commerce
Room 2123, Rayburn House Office Building
Washington, DC 20515

March 9, 1989

The Honorable James A. Baker III
Secretary
Department of State
2201 C Street, N.W.
Washington, D.C. 20520

Dear Mr. Secretary:

We are extremely concerned about the role the State Department appears to be playing in advocating a production standard for High Definition Television (HDTV). While the Department's focus may well be on the creation of an international standard, the fact of the matter is that U.S. adherence to an international production standard dictates a domestic standard as well.

While the State Department has a legitimate representational role to play in the International Telecommunications Union, we question the authority of the Department to become involved in the creation of a domestic production standard. We are also concerned that representatives of foreign corporations have served as advisors to the Department on this matter.

Please advise us as soon as possible, citing appropriate interagency agreements, of the authority of the Department to engage in the creation of a domestic production standard. As part of your response, please include the names of all representatives of foreign commercial establishments (or their U.S. subsidiaries) that served as members of any advisory committees on this matter. If any votes occurred during the course of any advisory committee meeting, please advise us of the positions taken by representatives of foreign corporations (or their U.S. subsidiaries) on the issues upon which an advisory committee might be voting.

Finally, we would like to request that the Department (and its advisory committees) refrain from further consideration of this matter pending your response to this letter.

Sincerely,

JOHN D. DINGELL
Chairman
Committee on Energy
and Commerce

EDWARD J. MARKEY
Chairman
Subcommittee on
Telecommunications and Finance

United States Department of State

Washington, D.C. 20520

APR 11

Dear Mr. Markey:

I am pleased to respond on behalf of Secretary Baker to your letter of March 9 concerning the role of the Department of State in the establishment of production standards for high definition television.

The Department of State's interest in HDTV standards follows generally from its foreign affairs responsibilities with respect to the International Telecommunication Union, and specificially from its Chairmanship of the U.S. National Committee for the Consultative Committee on International Radio (CCIR). The U.S. National Committee on the CCIR, established in 1951, is chartered as a Federal Advisory Committee. This is the only Advisory Committee to the State Department on production standards for HDTV. Representatives of the Department of Commerce's National Telecommunications and Information Administration and the Federal Communications Commission serve as Vice Chairmen of this Committee.

Internationally, HDTV has been a CCIR issue since the 1970's under Study Group 11 (Television). Since 1983 this group has focused on the question of a single world standard for the production and exchange of video programming. In response to your request, I am pleased to attach the membership lists for the U.S. National Committee for the CCIR and for Study Group 11.

In developing a U.S. position on international standards, the Department of State relies heavily on voluntary industry standards groups in the belief that such organizations provide the proper forum for considering the technical aspects of standards. The Department of State does not formulate initial positions. It coordinates the advisory committee process and develops strategy and tactics necessary to achieve the adoption of recommended U.S. positions in the international arena.

The Honorable
Edward J. Markey,
Chairman,
Subcommittee on Telecommunications and Finance,
House of Representatives.

Any standard, once adopted by the ITU, serves as a recommendation, and as such is voluntary. Presently, U.S. film and video production companies remain free to utilize whatever standard they might choose based on commercial considerations. If there were to be agreement on an HDTV production standard, the situation for U.S. companies would not change.

The Department of State has not been involved in the creation of a domestic production standard. Rather it has relied on the private sector organizations addressing the issue. Industry began studying the concept of an HDTV production standard in 1977, when the Society of Motion Picture and Television Engineers (SMPTE) formed a Working Group on HDTV. In 1984, a group composed of the National Association of Broadcasters (NAB), the National Cable Television Association (NCTA), the Electronic Industries Association (EIA), the Institute of Electrical and Electronics Engineers (IEEE) and SMPTE established the Advanced Television Systems Committee (the ATSC) to coordinate and develop voluntary national technical standards for advanced television systems. SMPTE and ATSC subsequently carried out extensive studies and evaluations before adopting the 1125/60 HDTV Standard as a national standard, subsequently known as SMPTE 240M, which ATSC subsequently recommended to the Department for submission to the CCIR as the U.S. position for an international HDTV production standard.

We understand SMPTE and the ATSC have periodically reviewed the question of an HDTV production standard. In January 1988, the ATSC approved the SMPTE 240 M proposal for the third time. The SMPTE Executive Committee for Standards approved SMPTE 240M in February 1988 and submitted it a month later to the American National Standards Institute (ANSI). The ANSI Board of Standards Review approved SMPTE 240M in October 1988, although it has been under appeal by one member since early 1989.

You inquired about votes which may have been taken during the advisory committee process and the role of representatives of foreign commercial establishments in any votes. The U.S. study groups and the National Committee for the CCIR operate by consensus. The positions the Department has advanced internationally were consensus positions, openly arrived at, with wide industry and government participation. No votes were taken. The private sector standards organizations have varying decision making processes which help them determine their positions, but the Department does not maintain records on these procedures.

With respect to the participation of "foreign corporations" in the advisory process, it should be noted that the U.S. Government policy is to encourage the broadest possible industry participation in the standards process. This position results from (1) the difficulty with defining a "foreign corporation" under the business conditions which exist today, (2) our fundamental belief that the interests of the people of the United States are best served by a fully open advisory process, and (3) the unrelenting efforts of the Executive Branch to persuade foreign governments and organizations to open their standards setting process to U.S.-based corporations. For example, during the Market Oriented Sector Specific (MOSS) telecommunications discussions with Japan, the United States obtained Japan's commitment to permit the representatives of U.S. firms to participate in meetings discussing product standards. U.S. firms in Europe also participate in European standards setting bodies. The new European Telecommunications Standards Institute is open to organizations based in one of the Western European nations.

I hope this information answers the concerns you expressed in your letter. I want to assure you that the Department of State is following with great interest the rapidly evolving domestic dialogue on HDTV as well as the continuously changing international scene. We have been in touch with the heads of the voluntary standards organizations and are encouraging their continuing review of the situation. In addition, however, the Administration will be reviewing the production standard issue as part of an overall review of advanced television policy. Our objective is to ensure that U.S. interests are vigorously promoted at any future international meeting on HDTV production standards.

Sincerely,

Janet G. Mullins

Janet G. Mullins
Assistant Secretary
Legislative Affairs

Attachment:
As stated.

NATIONAL SCIENCE FOUNDATION
WASHINGTON, D.C. 20550

nsf

OFFICE OF THE DIRECTOR

March 16, 1989

Honorable Edward J. Markey
Chairman, Subcommittee on
Telecommunications and Finance
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As I indicated in my letter to you of February 27, 1989, the Foundation currently conducts no programmatic research specifically focused on advanced television technologies. However, several of the basic research areas the Foundation does support could have implications for High Definition Television (HDTV), such as:

- Data compression, reconstruction and storage techniques;
- Signal processing and conversion;
- Multi-media human computer interaction; and
- High capability display systems.

The Foundation made awards in these research areas totalling about $750,000 in Fiscal Year 1988.

Through our Japanese Technology Evaluation Center, we are funding a study of the comparative status of Japanese and U.S. high definition television activities. A number of U.S. experts are participating in this analysis. A final report is anticipated in approximately six months. We would be pleased to provide you copies as soon as the report is available.

Secondly, NSF technical staff are participating in evaluation of proposals recently received by the Defense Advanced Research Projects Agency (DARPA). These proposals are in response to a DARPA request for proposals for high definition display research and development. While the funding and decisions for the proposals reside in DARPA, our staff will continue to cooperate with and monitor their activities.

Finally, the Foundation's 1989 Small Business Innovation Research (SBIR) program solicitation will include opportunities for small high-technology firms to submit proposals related to HDTV research. The solicitation also identifies HDTV as one of five areas of growing national importance.

Please contact me if you desire further details regarding any of these basic research activities conducted by NSF which could relate to HDTV.

Sincerely,

Erich Bloch
Director